MEMORANDUM OF LAW
FOR THE INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, INC.

Validity and Enforceability under English Law of
Collateral Arrangements under the ISDA Credit Support Documents

30 December 2015

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TABLE OF CONTENTS

I. INTRODUCTION

1. Overview and scope of issues covered by this memorandum

In this memorandum we consider the validity and enforceability under English law[1] of a collateral or margin arrangement[2] entered into in connection with an agreement between two parties based on one of the following standard form master agreements published by the International Swaps and Derivatives Association, Inc. (**ISDA**):

(1) the ISDA 2002 Master Agreement (the **2002 Agreement**); and

(2) the 1992 ISDA Master Agreement (Multicurrency – Cross Border) (the **1992 Agreement**).

References below to "the **ISDA Master Agreement**" or "an ISDA Master Agreement" apply equally, unless context otherwise requires, to an agreement based on the 2002 Agreement and one based on the 1992 Agreement. Where a distinction between the forms of ISDA Master Agreement is relevant to the analysis, we refer expressly to the relevant form.[3]

In this memorandum, we assume that each collateral arrangement entered into in connection with an ISDA Master Agreement between two parties is documented under one of the following standard form documents published by ISDA:

(a) the 1994 ISDA Credit Support Annex (Bilateral Form) governed by New York law (the **New York Annex**);

(b) the 1995 ISDA Credit Support Deed (Bilateral Form – Security Interest) governed by English law (the **English Deed** and, together with the New York Annex, the **Security Documents**); or

(c) the 1995 ISDA Credit Support Annex (Bilateral Form – Transfer) governed by English law (the **English Transfer Annex** and, together with the Security Documents, the **Credit Support Documents**).

In relation to each Credit Support Document entered into in connection with a 2002 Agreement, we assume that it has been entered into subject to the amendments set out in:

(i) in the case of the New York Annex, Annex 14 of the 2002 ISDA Master Agreement Protocol published by ISDA on 15 July 2003 (the **2002 Protocol**);

(ii) in the case of the English Deed, Annex 16 of the 2002 Protocol; and

(iii) in the case of the English Transfer Annex, Annex 15 of the 2002 Protocol.

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1 England and Wales form a single legal jurisdiction. In this memorandum, a reference to "English law" is a reference to the law of England and Wales (other than legislation passed by the Welsh Assembly) and, unless context indicates otherwise, a reference to "England" is a reference to the legal jurisdiction of England and Wales.

2 "Collateral arrangement" and "margin arrangement" are commercial terms, used interchangeably in the market. In this memorandum, we use the term "collateral arrangement", which appears to be the more commonly used term. We also use the term "financial collateral arrangement", but note that this term has a specific meaning under UK legislation, as explained in part II below.

3 Other forms of master agreement are published by ISDA, but the 2002 Agreement and 1992 Agreement are the two most widely used forms of master agreement, particularly for use in connection with a financial collateral arrangement of a type considered in this memorandum.

A capitalised term used and not defined in this memorandum has the meaning given to that term in the ISDA Master Agreement or the relevant Credit Support Document, according to context. The term "**security interest**", when used in this memorandum, refers to any form of security interest that may be created under a Security Document, although the precise nature of the interest will vary according to the governing law, the nature of the assets over which security is created, and other relevant circumstances.

Similarly, in this memorandum:

(A) in relation to the Security Documents, the term "**Security Collateral Provider**" refers to the Pledgor under the New York Annex or the Chargor under the English Deed;

(B) the term "**Collateral Provider**" (and in part II where used in respect of the Credit Support Documents, "**collateral-provider**") refers to the Security Collateral Provider under a Security Document or the Transferor under an English Transfer Annex; and

(C) the term "**Collateral Taker**" (and in part II where used in respect of the Credit Support Documents, "**collateral-taker**") refers to the Secured Party under a Security Document or the Transferee under an English Transfer Annex.

Subject to part III.2 below, the term "**Collateral**", when used in this memorandum, refers, in the case of each Security Document, to any securities or cash in respect of which a security interest is created by the Security Collateral Provider in favour of the Secured Party and, in the case of the English Transfer Annex, to any securities or cash transferred by the Collateral Provider to the Collateral Taker, in each case as credit support for the obligations of the Collateral Provider under the relevant ISDA Master Agreement.

The issues that you have asked us to address are set out below in italics, followed in each case by our analysis and conclusions. In particular, we consider certain issues in our response to questions 16 to 18 (in part III in respect of the Security Documents) and 25 to 27 (in respect of the English Transfer Annex) in the event of insolvency proceedings in England in relation to an English Company.

This memorandum (other than part VII in which we describe certain pending developments which we are aware may occur in the future) is limited to matters of English law as in effect on today's date. We have assumed that no foreign law qualifies or affects our analysis or conclusions set out below. No opinion is expressed on matters of fact.

As used in this memorandum, the term "**enforceable**" means that each obligation or document is of a type and form enforced by the English courts. It is not certain, however, that each obligation or document will be enforced in accordance with its terms in every circumstance, enforcement being subject to, among other things, the nature of the remedies available in the English courts. The power of an English court to grant an equitable remedy such as an injunction or specific performance is discretionary, and accordingly an English court might make an award of damages where an equitable remedy is sought. Enforcement is also subject to the discretion of the courts in the acceptance of jurisdiction, the power of such courts to stay proceedings, the provisions of the Limitation Act 1980, doctrines of good faith and fair conduct and laws based on those doctrines and other principles of law and equity of general application.

Finally, for purposes of our analysis below, we make reference to our Memorandum of Law dated 30 December 2015 for ISDA on the validity and enforceability under English law of close-out netting under the 2002, 1992 and 1987 ISDA Master Agreements (the **ISDA Netting Opinion**).

2. Scope of Counterparty types covered by this memorandum

In this memorandum, we consider the enforceability of each Credit Support Document against each type of English entity specified below and, to the extent indicated in part I.4 below, certain foreign entities.

(a) *English entities*

You have asked us to consider in this memorandum the following types of entities described in Appendix B (together, where applicable with a Foreign Entity, a **Counterparty**):

(i) a Corporation, if registered as a company in England under the Companies Act 2006[4] other than a company falling within Appendix C (an **English Company**);

(ii) a friendly society incorporated under the Friendly Societies Act 1992 with its registered office in England (a **Friendly Society**);[5]

(iii) a registered society under the Co-operative and Community Benefit Societies Act 2014 with its registered office in England (a **C/CB Society**);[6]

(iv) a body corporate established by private Act of Parliament with its principal place of business in England (a **Statutory Corporation**);[7]

(v) a body corporate established by royal charter granted by the Crown with its principal place of business in England (a **Chartered Corporation**);

(vi) a Bank/Credit Institution, if established as an English Company, having its head office in England and permitted under Part 4A of the Financial Services and Markets Act 2000 to carry on the regulated activity of accepting deposits (an **English Bank**);

(vii) an Investment Firm/Broker Dealer, if established as an English Company (an **English Investment Firm**);

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4 As provided in section 1 of the Companies Act 2006, this includes companies formed and registered under the Companies Act 2006, as well as companies formed and registered under a prior Companies Act or, in certain cases, formed under other English legislation or letters patent. This does not include branches of foreign corporations (referred to as "overseas companies" in the Companies Act 2006) registered as such under Part 34 of the Companies Act 2006.

5 A friendly society may also be unincorporated and registered under the Friendly Societies Act 1974, however such friendly societies are excluded from the scope of this memorandum. In addition, there are some unincorporated and unregistered friendly societies to which the legislation relating to friendly societies has no direct application. These friendly societies are associations of individuals with property commonly vested in trustees. An unincorporated and unregistered friendly society may not be authorised to conduct insurance business under the Financial Services and Markets Act 2000 and so are also excluded from the scope of this memorandum.

6 This includes societies previously registered or treated as registered under the Industrial and Provident Societies Act 1965 and societies formed and registered under the Co-operative and Community Benefit Societies Act 1965 as either co-operative or community benefit societies.

7 Note that this definition does not include a statutory corporation established under a public general Act of Parliament. Excluding English Companies (which are not normally referred to as "statutory corporations" in England), a corporation established under a public general Act of Parliament is normally established for a governmental, regulatory or other public purpose. Examples of statutory corporations with a public purpose not covered by this opinion include local authorities (for example, the county councils and county borough councils established by the Local Government Act 1888), the Board of the Pension Protection Fund (established by the Pensions Act 2004) and the Olympic Delivery Authority (established by the London Olympic Games and Paralympic Games Act 2006).

(viii) a building society registered in England under the Building Societies Act 1986, having its head office in England and permitted under Part 4A of the Financial Services and Markets Act 2000 to carry on the regulated activity of accepting deposits (an **English Building Society**);[8]

(ix) a Banking Group Company and a Bank Holding Company (each as defined in Annex 4 by reference to the Banking Act 2009 (the **Banking Act**)); [9]

(x) the trustee (a **Trustee**) of a trust governed by English law that is not subject to a special regulatory regime (an **English Trust**);

(xi) an Insurance Company, if authorised by the Prudential Regulation Authority (**PRA**) under Part 4A of the Financial Services and Markets Act 2000 with permission to carry on insurance business, that is, to effect and carry out contracts of insurance (which includes reinsurance) as principal and established as a body corporate under English law in one of the following forms (in each case, an **English Insurance Company**):

(i) an English Company;

(ii) a Friendly Society;

(iii) a C/CB Society;

(iv) a Statutory Corporation; or

(v) a Chartered Corporation;

(xii) an English registered charity within the meaning of section 1 of the Charities Act 2011 [10] and established either as a trust governed by English law (an **English Charitable Trust**) or as a body corporate under English law in one of the following forms (each, an **English Charity**, which term includes the Trustee(s) of an English Charitable Trust, unless context indicates otherwise):

(i) an English Company;[11]

(ii) a Friendly Society;

(iii) a C/CB Society;[12]

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8 This includes building societies formed under the Building Societies Act 1986 and building societies formed and registered under prior building societies legislation that are deemed to be registered under the Building Societies Act 1986 by virtue of section 5 of that Act.

9 The full definition of each of these terms in the Banking Act is complex and is set out in Annex 4.

10 Section 1 of the Charities Act 2011 defines "charity" as "an institution which: (a) is established for charitable purposes only; and (b) falls to be subject to the control of the High Court in the exercise of its jurisdiction with respect to charities".

11 An English Charity established as an English Company is normally established as a company limited by guarantee, that is, without share capital.

12 Note that C/CB Societies that were societies previously registered or treated as registered under the Industrial and Provident Societies Act 1965 and community benefit societies registered under the Co-operative and Community Benefit Societies Act 2014 can be charities but co-operative societies cannot be charities. Charitable C/CB Societies are currently exempt from registration with the Charity Commission until the transitory modifications in paragraph 4 of Schedule 9 to the Charities Act 2011 are brought to an end at which time it is expected that only non-profit private registered providers of social housing or registered social landlords will continue to be exempt (note that such entities are outside the scope of this opinion) (see paragraphs 26 and 27 of Schedule 3 of the Charities Act 2011).

(iv) a Statutory Corporation; or

(v) a Chartered Corporation;

(xiii) an Investment Fund organised under English law in one of the following forms:

(i) an open-ended investment company with variable capital (**Open-Ended Investment Company**) incorporated and authorised under the Open-Ended Investment Company Regulations 2001[13] (the **OEIC Regulations**) by the Financial Conduct Authority (the **FCA**) established and domiciled in England; or

(ii) a trust authorised as a unit trust scheme[14] (an **Authorised Unit Trust**) by the FCA for the purposes of the Financial Services and Markets Act 2000 by an authorisation order in force under section 243 of the Financial Services and Markets Act 2000;

(an Open-Ended Investment Company and the Trustee of an Authorised Unit Trust, being each, an **English Investment Fund**).[15]

(xiv) Standard Chartered Bank, which is a Bank/Credit Institution that is a Chartered Corporation;

(xv) the Bank of England, which is a Central Bank; and

(xvi) the United Kingdom acting through Her Majesty's Treasury, which is a Sovereign (in respect of the English Transfer Annex only),

(each, an **English Counterparty**).

(b) *Trusts and trustees under English law*

(i) Nature of a trust and the personal liability of a Trustee

In relation to an English Trust, an English Charitable Trust and an Authorised Unit Trust, it is important to note that a trust is not a legal person under English law. The trust is not capable therefore of entering into contracts or of suing or being sued in relation to any contract or other matter. Therefore one contracts with one or more Trustees on behalf of the trust. Each Trustee is personally liable for any obligations it incurs under the contract, but is not, in its capacity as a Trustee, beneficially entitled to any rights under the contract, such rights being held by each Trustee for the benefit of the beneficiaries of the trust.

For this reason, in this memorandum we consider the enforceability of the Credit Support Documents against a Trustee of an English Trust, English Charitable Trust or Authorised Unit Trust, as the case may be, rather than against the relevant trust.

(ii) Trustee's right of recourse to the assets of a trust

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13 SI 2001/1228.

14 By unit trust scheme we mean a single trust created in favour of a single defined pool of beneficiaries rather than a scheme that is an umbrella (as such term is used in the Collective Investment Schemes sourcebook forming part of the FCA Handbook).

15 We do not consider Investment Funds organised as Authorised Contractual Schemes in this memorandum.

Although a Trustee is personally liable for its obligations under a contract it enters into on behalf of the trust, it may seek to limit that personal liability to the extent of its right of recourse against the assets of the trust. Note that a Trustee is not able to exclude its personal liability entirely. The effect of such a limitation in a contract is simply to exclude the right of the other party to enforce the contract against its personal assets should the trust assets be insufficient to satisfy a claim against the Trustee arising under the contract.

Even in the absence of such a limitation on the liability of the Trustee, a creditor of the Trustee normally relies on the assumption that the Trustee has a right of recourse to the assets of the trust to fulfil its obligations incurred under a contract made on behalf of the trust. The personal assets of the Trustee are often wholly inadequate to cover such obligations, particularly in the context of a trust that is of a size justifying recourse to the wholesale derivatives market for risk management purposes.

Accordingly, it is important for a party to ensure as far as possible that a Trustee will be entitled to have recourse to the trust assets in order to meet its liabilities under a Credit Support Document between the party and the Trustee. There are ways, however, in which a Trustee may lose, partially or wholly, its right of access to the trust assets.

This is not, strictly speaking, a question of enforceability of the contract against the Trustee, and so any such impairment of the Trustee's right of recourse does not affect our analysis of the enforceability of a Credit Support Document (discussed in Annex 5 in relation to the Trustee of an English Trust, in Annex 12 in relation to the Trustee of an English Charitable Trust and in Annex 15 in relation to the Trustee of an Authorised Unit Trust).

In Appendix D to this memorandum, we set out various issues that are relevant to dealing with the Trustee of a trust governed by English law that do not go to the enforceability of the Trustee's contractual obligations under a Credit Support Document but to the question of whether the Trustee (or, in certain circumstances, the other party directly) has recourse to the assets of the trust in order to meet its liabilities and certain other issues of importance when dealing with a Trustee.

(iii) Trustees within the scope of this memorandum

A trust may have a single Trustee, which may be a private individual or a corporate Trustee, or it may have two or more Trustees, which may be private individuals, corporate Trustees or a combination of the two.

Where a trust has a single Trustee, it will ordinarily be a corporate Trustee, at least for a trust of a size justifying recourse to the wholesale derivatives market for risk management purposes. If such a trust has more than one Trustee, then normally at least one will be a corporate Trustee.

Where a trust has two or more Trustees, it is not normally necessary under the relevant trust deed that all Trustees enter into each contract. Accordingly, a party may enter into an ISDA Master Agreement and Credit Support Document with a corporate Trustee to which other Trustees (whether corporate entities or private individuals) of the same trust are not a party. This is not a problem if the Trustee with whom it has entered into the ISDA Master Agreement and Credit Support Document has the necessary power and authority to enter into the ISDA Master Agreement and Credit Support Document and each Transaction under the relevant trust deed.

When a party deals with a private individual, including a private individual acting as Trustee, there are a number of additional considerations, both legal and commercial, that arise that would not apply when dealing with a corporate entity. For example, the death or incapacity of a private individual would potentially affect the enforceability of obligations against the private individual or his estate. Additionally, unfair contract terms legislation and other consumer protection legislation, such as that relating to consumer credit, may affect the relationship between the party and the private individual.

Such matters are not specific to private individuals acting in their capacity as Trustee, but apply to dealings with private individuals generally. For this reason, and as is customary for opinions of this type, we have assumed for the purposes of this memorandum that the Trustee is an English Company, that is, is a corporate Trustee that is registered as a company under the Companies Act 2006 other than a company falling within Appendix C.

It does not, however, affect our analysis of the enforceability of a Credit Support Document against a particular corporate Trustee, that there may be one or more private individual Trustees for the relevant trust who may or may not be a party to the relevant ISDA Master Agreement or Credit Support Document on behalf of that trust.

We also assume that the Trustee is not subject to special regulatory regime (for example that it is not also a bank).

It is important to bear in mind that only a Trustee that has entered into, or subsequently has expressly agreed to assume contractual obligations under, a Credit Support Document is contractually bound to the other party to a Credit Support Document. Although the ISDA Master Agreement and the Credit Support Document may state that Party A or Party B consists of "the Trustees of the Trust acting on behalf of the Trust", this language does not impose legal liability on any Trustee that has not entered into the ISDA Master Agreement and the Credit Support Document either directly or through an agent.

Therefore, a Trustee appointed after the date a Credit Support Document has been entered into will not be bound unless the new Trustee specifically contracts with the other party to the Credit Support Document to assume the obligations of a Trustee under the Credit Support Document.

A retiring Trustee is not, by virtue of its retirement as a Trustee, relieved of its contractual obligations incurred on behalf of the trust, unless expressly relieved of those contractual obligations by the other party to the contract (regarding which, see further below). Those contractual obligations remain personal obligations of the retiring Trustee. A retiring Trustee will not, however, be liable for any subsequent contractual obligations incurred by a continuing or new Trustee on behalf of the trust, including, for example, any further Transaction entered into under the ISDA Master Agreement and the Credit Support Document.

Customarily, to the extent that it has continuing contractual obligations incurred on behalf of the trust, a retiring Trustee would be indemnified in relation to its remaining contractual obligations by the continuing Trustee(s) (if any) as well as the new Trustee (if any) appointed in its place. In addition, the retiring Trustee will still have the benefit of its indemnity against and lien over the trust assets, as described in Appendix D, to the extent that it is called upon, despite its retirement, to perform any such contractual obligation and it has not been indemnified by the continuing or new Trustee(s) and provided also that it has not impaired or lost its recourse to the trust assets, for any of the reasons discussed in Appendix D.

Similar principles apply in relation to the removal of a Trustee, although the circumstances of the removal of the Trustee may indicate a higher likelihood that the Trustee's right of recourse to the trust assets has been impaired or lost.

As a matter of practice, it is common in an ISDA Master Agreement and Credit Support Document with one or more Trustees for a particular trust that the Trustees agree that they shall procure that any replacement, successor or new Trustee shall assume and undertake to the other party all obligations and liabilities of the Trustees under the ISDA Master Agreement and Credit Support Document and that the new Trustee provide a letter, typically executed by deed, to that effect, to the other party. Upon satisfaction of this obligation, the ISDA Master Agreement and Credit Support Document will typically provide that either (i) the retiring Trustee will automatically be released from liability under the ISDA Master Agreement and Credit Support Document or (ii) upon request, the other party will execute a deed of release in a form satisfactory to the other party and the retiring Trustee.

In a case where a Trustee retires and no new Trustee is appointed but there is one or more continuing Trustees, and assuming that at least one of the continuing Trustees is a corporate Trustee that is a party to the ISDA Master Agreement and Credit Support Document, then the ISDA Master Agreement and Credit Support Document may provide for the release of the retiring Trustee upon confirmation by the retiring Trustee to the other party, typically in a letter executed by deed, that the retiring Trustee has transferred all his or its rights and title to the property and assets of the trust to the remaining Trustees in their capacity as Trustees of the trust.

In this memorandum, when we refer below to a "Trustee", we are referring to each Trustee that is bound by the terms of a given Credit Support Document from time to time.

Although we will generally below, for clarity and unless context otherwise requires (for example, in Annex 5 where we discuss Full Trustee Insolvency), refer to the Trustee in the singular (on the assumption, mentioned above, that there is a single corporate Trustee that is an English Company), our analysis applies *mutatis mutandis* to a Credit Support Document under which there is more than one Trustee that has entered into, or subsequently assumed obligations and liabilities under, the Credit Support Document on behalf of the relevant trust.

(iv) Trusts within the scope of this memorandum

We note that an English Charitable Trust and an Authorised Unit Trust are each subject to a specific and detailed regulatory regime. In this memorandum, we consider whether, in each case, the regulatory regime affects the enforceability of a Credit Support Document against a Trustee for the English Charitable Trust or Authorised Unit Trust, as the case may be.

In relation to an English Trust, other than an English Charitable Trust or Authorised Unit Trust, we assume that it is not subject to a specific regulatory regime that may affect the enforceability of a Credit Support Document against a Trustee for the English Trust. We therefore, for example, do not consider in this memorandum an English Trust that is an English occupational pension scheme, given the detailed regulatory regime applicable to such schemes.

(c) *Legal forms of an English Insurance Company, English Charity or English Investment Fund and certain other English entities that are outside the scope of this memorandum*

In this memorandum, we do not consider any other type of entity organised under English law, whether or not falling within any description in Appendix B.

This memorandum covers an English Insurance Company established in one of the five legal forms indicated above. This memorandum does not extend to an English insurance company established in any other form, for example, as a form of partnership. It also does not extend to an underwriting member of Lloyd's of London, as a separate insolvency regime would be applicable.[16]

This memorandum covers an English Charity established in one of the six forms indicated above. This memorandum does not extend to an English charity established in any other form, for example, as an unincorporated association or a charitable incorporated organisation established under the Charities Act 2011 and nor does it extend to charitable common investment funds, charitable common deposit funds or other charitable investment funds.

This memorandum covers an English Investment Fund established in one of the two forms indicated above. This memorandum does not extend to an English investment fund established in any other form including authorised contractual schemes, common investment funds or common deposit funds (relating to charities, pension funds or any other sector).

For the avoidance of doubt, and without limiting the generality of the above, the following types of entity that may be established under English law are also outside the scope of this memorandum: a general partnership, a limited partnership, a limited liability partnership, pension funds, a private registered provider of social housing or a registered social landlord (commonly known as a housing association), a credit union, a local authority[17] and an educational establishment established under the Further and Higher Education Act 1992. We also do not consider ISDA Master Agreements entered into on a joint, several or joint and several basis (for example, where a bank is one party to the ISDA Master Agreement and the other named party is in fact two separate entities).

Finally, we do not consider in this memorandum the enforceability of the Credit Support Documents against a natural person (private individual), whether acting for his or her own account or as a trustee in relation to any form of trust or in any other capacity.

(d) *Legal capacity and regulatory issues generally*

Each of the Counterparty types you have asked us to consider in this memorandum is potentially subject to requirements under its constitutional document (for example, the trust deed in relation to a trust) or to legal or regulatory requirements/restrictions (for example in respect of Authorised Unit Trusts) that may affect the legality or validity of its entering into certain types of Transaction under an ISDA Master Agreement or a Credit Support Document in connection with an ISDA Master Agreement. It may be, for example, that a Counterparty of that type is only permitted to enter into Transactions for hedging purposes or for the purposes of efficient portfolio management. We do not consider such issues in this memorandum.[18] The list of Transactions in Appendix A should therefore be read accordingly – the inclusion of a Transaction in Appendix A does not mean that a particular English Counterparty has capacity to enter into that Transaction.[19]

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16 Insurers (Reorganisation and Winding Up) (Lloyd's) Regulations 2005 SI 2005/1998.

17 This exclusion includes a local authority acting in relation to its local authority pension scheme, administered by the local authority under specific legislation in connection with the national Local Government Pension Scheme.

18 We note, however, that when considering these issues in relation to a corporate Trustee, one should bear in mind the distinction between the capacity of the Trustee in its own right (for example, its capacity to act as a trustee), which will be governed by its own corporate constitution, and the capacity of the Trustee to act on behalf of the trust, which will be governed by statute and the relevant trust deed.

19 For example, in respect of English Building Societies, see the restrictions in section 9A of the Building Societies Act 1986.

Therefore issues of the legal capacity and authority of a Counterparty to enter into any specific type of Transaction is outside the scope of this memorandum. Note that we also do not consider the various powers that may be available in respect of each type of Counterparty to transfer all or part of its assets to another entity or convert itself into another type of entity. We do, however, consider the transfer powers in Part VII of the Financial Services and Markets Act 2000 given the focus on transfers in the context of English Banks and English Insurance Companies and the related stay on termination following a Part VII transfer.

More generally, we do not advise in this memorandum on regulatory issues relating to derivatives dealings by any Counterparty type falling within the scope of this memorandum. Without prejudice to the generality of the foregoing, we do not consider whether any Collateral would constitute client assets or client money for the purposes of the Client Assets sourcebook (CASS) (forming part of the FCA Handbook).

3. Assumptions

We indicate where relevant any assumptions that you have asked us to make.

In addition, we make the following assumptions throughout this memorandum:

(a) To the extent that any obligation arising under the ISDA Master Agreement or Credit Support Document falls to be performed in any jurisdiction outside England, its performance will not be illegal or ineffective by virtue of the laws of that jurisdiction.

(b) Each party (i) is able lawfully to enter into the ISDA Master Agreement, the Transactions thereunder and the Credit Support Document under the laws of its jurisdiction of incorporation and under its relevant constitutional documents, (ii) has taken all corporate action necessary to authorise its entry into the ISDA Master Agreement, the Transactions thereunder and the Credit Support Document, and (iii) has duly executed and delivered the ISDA Master Agreement, each Transaction and the Credit Support Document.

(c) If the ISDA Master Agreement is governed by English law, the ISDA Master Agreement (except, when used with the English Transfer Annex, to the extent that the English Transfer Annex relies on provisions of the ISDA Master Agreement for its effectiveness) would, when duly entered into by each party, constitute legally binding, valid and enforceable obligations of each party under English law.

(d) Each of the parties to the ISDA Master Agreement and Credit Support Document who is carrying on, or purporting to carry on, any regulated activity in the United Kingdom is an authorised person permitted to carry on that regulated activity or an exempted person in respect of that regulated activity under the Financial Services and Markets Act 2000 and neither the ISDA Master Agreement nor any Credit Support Document was entered into in consequence of a communication made in breach of section 21(1) of the Financial Services and Markets Act 2000.

(e) Each of the parties is acting as principal and not as agent in relation to its rights and obligations under the ISDA Master Agreement and Credit Support Document, and no third party has any right to, interest in, or claim on any right or obligation of either party under either document.

(f) The terms of the ISDA Master Agreement, including each Transaction under the ISDA Master Agreement, and the Credit Support Document are agreed at arms' length by the parties so that no element of gift or undervalue from one party to the other party is involved.

(g) In deciding to enter into the ISDA Master Agreement, including each Transaction, and the Credit Support Document or to make any payment or delivery in accordance with the ISDA Master Agreement, including each Transaction, and the Credit Support Document, neither party was influenced by a desire to put the other party into a position which, in the event of the former party going into insolvent liquidation, would be better than the position the latter party would have been in would have been in if the ISDA Master Agreement, such Transaction or the Credit Support Document had not been entered into or such payment or delivery had not been made.

(h) At the time of entry into the ISDA Master Agreement, including each Transaction under the ISDA Master Agreement, and the Credit Support Document, no insolvency, administration, resolution, rescue, or composition proceedings have commenced in respect of either party, and neither party is insolvent at the time of entering into the ISDA Master Agreement, including each Transaction under the ISDA Master Agreement, or the Credit Support Document or becomes insolvent as a result of entering into such documents.

(i) Each Security Collateral Provider, when transferring Collateral in the form of securities as part of a Delivery Amount under a Security Document, will have full legal title to such securities at the time of transfer, free and clear of any lien, claim, charge or encumbrance or any other interest of the transferring party or of any third person (other than a lien routinely imposed on all securities in a relevant clearance or settlement system).

(j) Each party, when transferring Collateral in the form of securities as part of a Delivery Amount or Return Amount under the English Transfer Annex, will have full legal title to such securities at the time of transfer, free and clear of any lien, claim, charge or encumbrance or any other interest of the transferring party or of any third person (other than a lien routinely imposed on all securities in a relevant clearance or settlement system).

(k) Each English Counterparty has its centre of main interests (**COMI**) for purposes of the EC Insolvency Regulation in England.[20] We make this assumption because if the EC Insolvency Regulation applies and the COMI is in another member state of the European Union, then that other member state has primary insolvency jurisdiction under the EC Insolvency Regulation (that is, it has, in the terminology of the EC Insolvency Regulation, jurisdiction to open "main proceedings") and the jurisdiction of the English courts is limited to opening either "secondary proceedings" or "territorial proceedings", in either case only if there is an establishment in the United Kingdom.[21]

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20 Council Regulation 1346/2000/EC on insolvency proceedings [2000] OJ L160.

21 Article 3 of the EC Insolvency Regulation. If main proceedings have been opened in another EU member state, only secondary proceedings may be opened in England. Secondary proceedings must be winding up proceedings and would not be conducted on a universal basis but would be limited in effect to assets and liabilities of the establishment of the English Company in the United Kingdom. Prior to the opening of main proceedings, "territorial proceedings" may be opened in England, subject to certain additional conditions set out in Article 3(4) of the EC Insolvency Regulation. Territorial proceedings may, under Articles 36 and 37 of the EC Insolvency Regulation, be converted in effect to secondary proceedings at the request of the liquidator in the main proceedings.

(l) To the extent applicable, each Foreign Entity has its COMI for the purposes of the EC Insolvency Regulation outside of England.

4. Fact patterns

You have asked us, when responding to each question, to distinguish between the following three fact patterns:

(a) The Location of the Collateral Provider is in England and the Location of the Collateral is outside England.

(b) The Location of the Collateral Provider is in England and the Location of the Collateral is in England.

(c) The Location of the Collateral Provider is outside England and the Location of the Collateral is in England.

For the foregoing purposes:

(i) the **Location** of the Collateral Provider is in England if it is an English Counterparty.

(ii) the **Location** of the Collateral Provider is outside England if it is a Foreign Entity.

(iii) the **Location** of Collateral is the place where an asset of that type is located under the private international law rules of England. See our answer to question 2 in part III of this memorandum for further details in this regard.[22]

A **Foreign Entity** is a corporate entity that is a Corporation, Bank/Credit Institution, Investment Firm/Broker Dealer or Hedge Fund/Proprietary Dealer organised/incorporated in a foreign jurisdiction under a foreign law.

In respect of a Foreign Entity, we assume that no that no insolvency proceedings have been commenced, or resolution action taken, against the Foreign Entity in England or elsewhere and therefore only consider a Foreign Entity in respect of the questions that do not relate to insolvency proceedings or resolution action.

However, in Annex 1 we discuss the consequences of the commencement of insolvency proceedings in England in respect of the English branch of a Foreign Entity incorporated outside of the UK that is a Bank/Credit Institution (an **English Branch**) where such English Branch is providing the Collateral. We also briefly consider the application of the resolution regime in the Banking Act in these circumstances.

Although we do not expressly refer to each fact pattern in our answer to each question, we have taken the fact patterns into consideration in developing our analysis. It should generally be clear from the context which of the fact patterns is being discussed in each case. For example, the use of the defined term "English Company" to refer to a Counterparty clearly excludes a Foreign Entity under fact pattern (c). In addition, it should generally be clear from the terms of the question whether the Collateral is to be considered as located in England or in a foreign jurisdiction.

22 Unless otherwise indicated, when we talk of the 'location' of Collateral in this memorandum, we mean the legal jurisdiction that governs the proprietary aspects of the Collateral determined in accordance with our answer to question 2.

Note that, as a general rule, neither the location nor the form of organisation of the Collateral Taker is relevant to consideration of the enforceability of a collateral arrangement against a Collateral Provider in the event of insolvency proceedings in England in respect of the Collateral Provider.

5. Structure of this memorandum

Part II considers the treatment of Credit Support Documents as financial collateral arrangements and the applicable legislation.

Part III considers the issues relating to the creation, perfection, and enforcement of security interests created in respect of Collateral delivered under each of the Security Documents.

Part IV considers the issues relating to the transfer of title approach pursuant to the English Transfer Annex.

Parts V to VII of this memorandum deal with additional matters you have asked us to consider.

Appendices A to D to this memorandum are described in this memorandum, in each case, where the first cross-reference to such Appendix is made.

Annexes 1 to 17 to this memorandum deal with the additional counterparty types you have asked us to cover as set out above.

II. FINANCIAL COLLATERAL ARRANGEMENTS

1. Introduction

Before turning to the specific questions you have asked us to address, we consider Directive 2002/47/EC of the European Parliament and Council of 6 June 2002 on financial collateral arrangements (the **Collateral Directive**). The Collateral Directive was implemented in the United Kingdom, including England and Wales, by the Financial Collateral Arrangements (No. 2) Regulations 2003 (the **FCA Regulations**),[23] which came into effect on 26 December 2003.

The purpose of the Collateral Directive was to strengthen the legal certainty and enforceability of collateral arrangements involving the delivery of financial assets to secure financial obligations by creating a common set of principles applicable to such arrangements under the laws of each member state of the European Union, including the elimination of formalities for the creation, perfection and enforcement of such an arrangement and its protection from the effects of certain insolvency rules that might otherwise apply to restrict or prevent its creation or enforcement.

In other words, the Collateral Directive was intended to strengthen the legal certainty of collateral arrangements in common use in the financial markets and to create a protective regime or "safe harbour" to ensure the enforceability of such arrangements notwithstanding the insolvency of the collateral provider.

The FCA Regulations have a number of important effects in relation to "financial collateral arrangements", consistent with the purposes of, and policy underlying, the Collateral Directive. The FCA Regulations cut across a number of issues discussed in this memorandum, and therefore we think it is important to discuss the scope and effects of the FCA Regulations at the outset of this memorandum, before turning to your specific questions.

For the purpose of this discussion, we make each of the assumptions in part I.3, part III.2 and part IV.2 as applicable.

2. Each Credit Support Document constitutes a financial collateral arrangement

In our view, on the assumptions in part I.3, part III.2 and part IV.2 and for the reasons given below, a collateral arrangement entered into under any of the Credit Support Documents in connection with an ISDA Master Agreement on or after 26 December 2003[24] would constitute a "financial collateral arrangement" for purposes of the FCA Regulations.

3. Overview of the FCA Regulations

Under the FCA Regulations, there are two types of financial collateral arrangement, a security financial collateral arrangement and a title transfer financial collateral arrangement. The party providing collateral is a "collateral-provider" under the FCA Regulations, and the party receiving collateral is a "collateral-taker". The collateral-provider provides financial collateral to secure or otherwise cover "relevant financial obligations" owed to the collateral-taker depending on the type of financial collateral arrangement.

23 SI 2003/3226. The "(No. 2)" in the title of the FCA Regulations reflects the fact that the original set of implementing regulations were revoked before coming into effect due to technical errors in the text.

24 26 December 2003 was the date that the FCA Regulations (other than the Regulation 2) came into force. Briggs J also stated that the FCA Regulations do not have retroactive effect in *Re Lehman* [2012] EWHC 2997 (Ch) [159]-[160].

"**relevant financial obligations**" are defined in the FCA Regulations as "the obligations which are secured or otherwise covered by a financial collateral arrangement …". This definition immediately presents a degree of circularity in the analysis because we are seeking to determine whether each Credit Support Document is a "financial collateral arrangement", and yet the definition of "relevant financial obligations" uses the term "financial collateral arrangement".

Under a security financial collateral arrangement, the collateral-provider (as defined in the FCA Regulations) creates a security interest in the financial collateral in favour of the collateral-taker to secure "relevant financial obligations". Under a title transfer financial collateral arrangement, the collateral-provider transfers "legal and beneficial ownership" of the financial collateral to the collateral-taker to "secure or otherwise cover" the relevant financial obligations owed to the collateral-taker. The FCA Regulations have a more significant effect in relation to security arrangements under English law than in relation to title transfer arrangements, as discussed in more detail in this part II and in parts III and IV of this memorandum.

In either case, however, a collateral arrangement has to fall within the terms of the relevant definition in order to benefit from the protective effects of the FCA Regulations. Accordingly, we look at each definition in turn as applied to the Credit Support Documents.

4. Application of the FCA Regulations to the Security Documents

We are of the view that, on the assumptions we have made, a collateral arrangement constituted by a Security Document entered into on or after 26 December 2003 in connection with an ISDA Master Agreement would be a security financial collateral arrangement as defined in the FCA Regulations.

The definition in the FCA Regulations of a "security financial collateral arrangement" is an agreement or arrangement evidenced in writing, where:

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

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

(c) 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"; and

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

In order to constitute a security financial collateral arrangement for the purposes of the FCA Regulations, it is necessary to ensure that the Security Documents satisfy each of the limbs set out above.

The first requirement is satisfied given that each Security Document is an arrangement evidenced in writing. The New York Annex is an annex to the Schedule to the ISDA Master Agreement and is expressed to supplement, form part of and be subject to the ISDA Master Agreement. The English Deed is a stand-alone agreement between the parties and is expressed to be a Credit Support Document in relation to the related ISDA Master

Agreement.[25] This aspect of the definition is, therefore, satisfied in relation to each Security Document.

We will now consider each of limbs (a) to (d) in turn.

4.1 *Is the purpose of the Security Document to secure "relevant financial obligations"?*

As noted above, the term "relevant financial obligations" is defined in the FCA Regulations as "the obligations which are secured or otherwise covered by a financial collateral arrangement ...". That said, on reflection, we do not believe that this circularity in the definitions would trouble an English court or prevent it from concluding that the Obligations (as defined in Paragraph 12 of each Security Document) fall within the broad scope of "relevant financial obligations".

The drafting of the Security Documents, in particular Paragraph 2 of each of the Security Documents, clarifies that the security interests in the collateral granted to the collateral-taker are given to secure the Obligations. As such we believe that the purpose of the Security Documents is to secure "relevant financial obligations".

The amount of financial collateral to be provided by the collateral-provider under Paragraph 3 of each of the Security Documents to the collateral-taker is determined by reference to the Exposure of the collateral-taker to the collateral-provider under the ISDA Master Agreement. Roughly speaking, this is the amount that would be owed by the collateral-provider to the collateral-taker if an Early Termination Date were designated or deemed to occur on the relevant Valuation Date.[26] In other words, the amount of financial collateral to be provided by the collateral-provider is primarily determined by reference to the credit exposure of the collateral-taker to the collateral-provider under the ISDA Master Agreement as of the Valuation Date.

4.2 *Is a security interest in "financial collateral" created?*

Regarding condition (b) of the definition, Paragraph 2 of the New York Annex expressly creates "a first priority continuing security interest in" Posted Collateral transferred to or received by the Secured Party under the New York Annex. As the New York Annex is governed by New York law and we are not opining on that law in this memorandum, we assume that the New York Annex is effective under New York law to create a security interest in Posted Collateral. Paragraph 2(b) of the English Deed also creates security over Posted Collateral.

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25 The related ISDA Master Agreement is identified on the first page of the English Deed by reference to the date of the ISDA Master Agreement and the identities of the parties.

26 The definition of "Exposure" in Paragraph 10 of the English Deed is determined by reference to Section 6(e)(ii)(1) of the ISDA Master Agreement, which applies following a Termination Event with one Affected Party subject to the proviso that (i) in respect of a 1992 Agreement, Market Quotations will be determined at mid-market of the amounts that would be paid for Replacement Transactions; and (ii) in respect of a 2002 Agreement, the Close-out Amount will be determined using 'estimates at mid-market of the amounts that would paid for transactions providing the economic equivalent of (x) the material terms of the Transactions…. and (y) the option rights of the parties in respect of the Transactions.' The definition of "Exposure" in Paragraph 10 of the New York Annex is determined by reference to (x) Section 6(e)(ii)(2)(A) of the 1992 Agreement, which applies following a Termination Event with two Affected Parties and (y) Section 6(e)(ii)(1) of the 2002 Agreement, which applies following a Termination Event with one Affected Party subject in each case to the same provisos that apply to the English Deed. Both definitions yield a calculation that is slightly more favourable to the collateral-provider than would be the case if the determination were simply made by reference to Section 6(e)(i). That, however, is essentially a matter of mechanics and was, presumably, considered more appropriate commercially for an on-going collateral arrangement in the absence of default by the ISDA working groups that drafted the Security Documents. Other factors, in particular, the specification of Independent Amount(s) in relation to the collateral-provider can be set to ensure that the collateral-taker is not likely to be undercollateralised in the event of a default occurring on or shortly after the settlement of the Delivery Amount determined in respect of that Valuation Date.

In relation to each Security Document, we have assumed in part III.2 of this memorandum that Eligible Collateral is in the form of cash credited to an account (as opposed to physical notes and coins) denominated in a freely convertible currency and held in an account under the control of the Secured Party[27] or securities held in one of the forms specified in assumption (g) in part III.2 below.

The term "financial collateral" is defined in the FCA Regulations as being "either cash, financial instruments or credit claims" and "financial instruments" includes "bonds and other forms of instruments giving rise to or acknowledging indebtedness if these are tradable on the capital market". *Prima facie* the collateral contemplated by our assumption in part III.2 will constitute "financial collateral". However, it is a question of fact whether any particular debt obligation would indeed constitute financial collateral (i.e. being "tradeable on the capital market").

4.3 *Is the financial collateral in the "possession or under the control" of the collateral-taker?*

"*Possession or control*"

The question then is whether the collateral is "in the possession or under the control of" the collateral-taker or a person acting on its behalf. The only cases on this point that have been decided by the English courts are (i) *Gray v G-T-P Group Ltd.*[28], where the collateral-provider had a free right to withdraw collateral under the arrangement, which the court held to be a floating charge and (ii) *Re Lehman Brothers International (Europe) (in administration*)[29], in which the court considered, among other matters, whether an interest expressed as a general lien gave rise to a security financial collateral arrangement for the purposes of the FCA Regulations.

Definition of "possession"

In *Gray,* Vos J concluded that "possession" was not possible in the context of intangible property and considered what was required to constitute "control" for the purposes of the FCA Regulations. He distinguished between (a) administrative control, whereby a collateral-taker may merely hold the financial collateral (for example, as a custodian) and (b) legal control, which would entitle the collateral-taker to prevent the collateral-provider "*from using or dissipating the assets in the ordinary course of business*"[30] and held that legal control is required for the security to be a security financial collateral arrangement under the FCA Regulations (so administrative control without legal control would be insufficient for the security to be a security financial collateral arrangement under the FCA Regulations).

An amendment to the FCA Regulations was made after the decision in *Gray*, to introduce a definition of "possession" as follows:

> *"For the purposes of these Regulations "possession" of financial collateral in the form of cash or financial instruments includes the case where financial collateral has 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*

27 Assumptions (f) and (h) in part III.2 below.

28 [2010] EWHC 1772 (Ch).

29 [2012] EWHC 2997 (Ch)

30 *Gray* [54]

relation to that financial collateral are limited to the right to substitute financial collateral of the same or greater value or to withdraw excess financial collateral".

While the amendment to the FCA Regulations detailed above clarified that the concept of "possession" could apply to intangibles, as noted by the Financial Markets Law Committee (**FMLC**) in their post-*Re Lehman* paper,[31] the exact requirements needed to satisfy the "possession or control test" are still subject to uncertainty.

However, the express reference to rights of substitution and withdrawal of excess collateral in the definition of "possession", indicates that legal control is required for possession; and in *Re Lehman*, Briggs J held that *"…both "possession" and "control" mean something more than mere custody of financial collateral by the collateral-taker under an agreement giving the custodian no more dominion over it [the collateral] than that of a pure nominee."*[32] In other words, the collateral-taker must have rights over the collateral in addition to holding (or having had delivered or transferred to it) the relevant collateral.

"Dispossession" as the key question

It is not clear whether "possession" and "control" are intended to be distinct concepts. While the language used in the FCA Regulations suggests that they are, in *Re Lehman*, Briggs J indicated that the key question to establish whether the "possession or control" test has been satisfied is whether the collateral-provider been sufficiently dispossessed by virtue of the degree of administrative and legal control accorded to the collateral-taker, thus conflating the two tests.[33] In determining whether the collateral-provider has been sufficiently "dispossessed" of the collateral, the scope and purpose of the Directive should be considered and emphasis should be placed on the extent of residual risk of fraud by the collateral-provider.[34] The purpose of the Directive is set out in the Recitals. Recital 10 (cited by Briggs J in *Re Lehman*)[35] provides that there must be a "balance between market efficiency and the safety of the parties to the arrangement and third parties, thereby avoiding *inter alia* the risk of fraud".

It is not certain what features of a collateral arrangement are essential to establish that the collateral-provider has been sufficiently "dispossessed". This may depend on the nature of the financial collateral (for example, the requirements for establishing "possession or control" in relation to financial collateral in the form of credit claims may well be different to the requirements for establishing "possession or control" in relation to financial collateral in the form of book entry securities). However:

(i) it is clear from the statements of Vos J in *Gray* and Briggs J in *Re Lehman* that "legal control" is required, so it is necessary to consider to what extent the legal agreement

31 Analysis of uncertainty regarding the meaning of ‘‘possession or … control’’ and ‘‘excess financial collateral’’ under the Financial Collateral Arrangements (No. 2) Regulations 2003 December 2012 (Financial Markets Law Committee). The paper may be accessed at: http://www.fmlc.org/uploads/2/6/5/8/26584807/0112121.pdf (accessed on 30 December 2015)

32 *Re Lehman* [131]

33 ibid, [136] Briggs J: *"In my judgment what needs to be shown (in order to bring a particular collateral arrangement within the protection of the FCARs), is that the terms upon which it is "provided" (art 2.2) or "delivered, transferred, held, registered or otherwise designated" (Regulation 3) are such that there is shown to be sufficient possession or control in the hands of the collateral taker for it to be proper to describe the collateral provider as having been "dispossessed" (Recital 10)…"*

34 ibid [92] and [128]: Briggs J stated that it is for the national court to construe the domestic legislation (here the FCA Regulations) as far as possible in a manner which does not derogate from the intended scope of the Directive and that any interpretation of the Directive must be "purposive".

35 ibid [78]: Briggs J considers the inclusion of a requirement for "possession or control" against the backdrop of the Directive, and states: *"But the need to balance the protection of the contracting parties, and third parties, from the risk of fraud meant that the new regime should extend only to financial collateral arrangements which provide some form of dispossession of the grantor in relation to the property provided as collateral: see Recital 10".*

permits the collateral-provider to deal with the Collateral. If the terms of the agreement are that the collateral-provider can demand, at any time, the return of the collateral (other than pursuant to a right of substitution or a right to withdraw excess, as to which see below) without any right for the collateral-taker to refuse, the "possession or control" test will not be satisfied because the collateral-provider cannot be said to have been dispossessed of the collateral to a meaningful degree[36];

(ii) it is not clear to what extent other rights in relation to the Collateral (for example, voting rights and rights to receive distributions) are relevant to the question of whether the collateral-provider has been sufficiently "dispossessed". There is no case law of which we are aware which addresses the question of the extent to which the allocation of entitlement to exercise voting rights arising with respect to financial collateral is a relevant factor in determining whether the collateral-provider can be said to have been sufficiently "dispossessed" and, in our view, the fact that a collateral-provider retains voting rights prior to an enforcement event should not mean that the collateral provider is not sufficiently "dispossessed"[37];

(iii) the better view is that the conduct of the parties to the collateral arrangement is also relevant when determining whether the collateral-provider has been sufficiently "dispossessed"[38] . So if legal rights of control are set out in the documentation but are not exercised by the collateral-taker there may be a risk that the possession or control test will not be satisfied; and

(iv) while the precise degree of "administrative" or "practical" control required in order to establish "possession or control" was not considered in detail in *Gray* or *Re Lehman*, in practice, it is our view that in cases where there is a third party custodian which has opened a secured account in the name of the collateral-provider (although this is not envisioned by the Security Documents), the collateral-taker would also need to retain administrative control in respect of the collateral in order to reduce residual risk of fraud by the collateral-provider, as contemplated by the concept of "dispossession".

It should be noted that the definition of "security financial collateral arrangement" in the FCA Regulations provides that "any right of the collateral-provider to substitute financial collateral of the same or greater value or withdraw excess financial collateral…shall not prevent the financial collateral being in the possession or under the control of the collateral taker". So the FCA Regulations expressly contemplate that it is possible to have a "security financial collateral arrangement" where the collateral-provider retains such rights and so the charge is potentially a floating charge.

However, if the terms of the arrangement are such that the collateral-taker has no right to confirm any valuation of the collateral-provider and, if such valuation cannot be verified, to veto any substitution or withdrawal of the collateral, then, in light of the discussion above, it is our view that there would be a risk that the collateral-provider will not have been sufficiently "dispossessed" of the collateral to satisfy the "possession or control" test (because he will be lacking the requisite administrative control).

36 ibid [134]

37 This is consistent with the view submitted by the legal author Beale - see H Beale and others, *The law of Security and Title-Based Financing* (2nd edition, OUP 2012), para 3.52

38 *Re Lehman* [149-152]: Briggs J discussed conduct and concluded that it is relevant where the documents are silent as to the parties rights (otherwise the parties rights should be taken into account). However, in light of the principles established in *Re Spectrum Plus [2005] UKHL 41* and *Brumark Investments Limited [2005] 2 AC 680* the better view (supported by the legal author Beale see H Beale and others, *The law of Security and Title-Based Financing* (2nd edition, OUP 2012) para 3.44) is that conduct should be taken into account even where the parties' rights are set out in the legal documentation.

4.4 *Characterisation of the Security Documents as a "security financial collateral arrangement"*

Our analysis therefore needs to consider if and how the Security Documents permit the collateral-provider to deal with the Collateral.

Turning to the provisions of the Security Documents, we note that:

(i) subject to the satisfaction of any eligibility criteria in Paragraph 13, the collateral-taker may either hold the Collateral itself or appoint a Custodian to hold the Collateral on its behalf (rather than on behalf of the collateral-provider);

(ii) following an Event of Default or Specified Condition or the occurrence of an Early Termination Date as a result of such event, the collateral-taker may unilaterally sell or otherwise dispose of the Collateral;

(iii) under the Security Documents, the collateral-taker is obliged to return to the collateral-provider (A) the Return Amount; (B) Distributions and any Interest Amount (to the extent a Delivery Amount would not be created or increased), in each case provided no Event of Default, Potential Event of Default or Specified Condition has been designated with respect to the collateral-provider and no Early Termination Date has occurred or been designated for which any unsatisfied payment obligations exist as a result of an Event of Default or Specified Condition with respect to the collateral-provider; and (C) all Posted Credit Support, if no amounts are or may thereafter become payable by the collateral-provider with respect to any Obligations;

(iv) pursuant to Paragraph 4(d) of the Security Documents, provided that no Event of Default has occurred and is continuing, the collateral-provider may propose, by written notice to the collateral-taker and the Custodian, the substitution of new Collateral for existing Collateral. Under the English Deed the consent of the collateral-taker is required under Paragraph 4 itself whereas under the New York Annex the parties may specify in Paragraph 13(e)(ii) that the Security Collateral Provider must obtain the consent of the Secured Party to any substitution pursuant to Paragraph 4(d) of the New York Annex; and

(v) under Paragraph 6(e) of the English Deed, provides that, prior to a Relevant Event or Specified Condition, the collateral-provider may exercise or direct the Secured Party to exercise any voting rights attached to securities forming part of the Collateral. The fact that, under the English Deed, the collateral-taker effectively only retains "possession or control" of the voting rights on and from the occurrence of a Relevant Event may be a relevant consideration for an English court in determining whether the collateral-taker has the requisite level of "possession or control" under the FCA Regulations. However, we consider the better view to be that retention of voting rights prior to the occurrence of a Relevant Event would not preclude the collateral-taker from exerting the necessary level of "possession or control" to comply with the FCA Regulations.

On the basis of the above and the assumptions we have made we believe that there are good arguments that the collateral-provider under the Security Documents has been sufficiently dispossessed of the Collateral in order to satisfy the "possession or control" test, as the Collateral is posted to the collateral-taker itself or a Custodian holding the Collateral on behalf of the collateral-taker and the circumstances in which the collateral-provider is entitled to have the Collateral returned are limited to situations where the withdrawal relates to excess collateral or substitute collateral.

4.5 *Are the collateral-provider and the collateral-taker non-natural persons?*

Moving onto the final limb of the definition of "security financial collateral arrangements", under the FCA Regulations a "non-natural person" is "any corporate body, unincorporated firm, partnership or body with legal personality except an individual …". We assume that both parties to the Security Documents are non-natural persons.

5. Conclusion in relation to the FCA Regulations analysis in respect of the Security Documents

On the basis of our analysis above, we believe that each Security Document when entered into on or after 26 December 2003 in connection with an ISDA Master Agreement should be characterised as a "security financial collateral arrangement" for the purposes of the FCA Regulations on the basis that the collateral-taker enjoys the requisite degree of legal and administrative control over the Collateral.

6. Application of the FCA Regulations to the English Transfer Annex

We are of the view that, on the assumptions we have made, a collateral arrangement constituted by an English Transfer Annex entered into in connection with an ISDA Master Agreement would be a title transfer financial collateral arrangement as defined in the FCA Regulations.

The definition in the FCA Regulations of a "title transfer financial collateral arrangement" is as follows:

> "'title transfer financial collateral arrangement' means an agreement or arrangement, including a repurchase agreement, evidenced in writing, where –
>
> (a) the purpose of the agreement or arrangement is to secure or otherwise cover the relevant financial obligations owed to the collateral-taker;
>
> (b) the collateral-provider transfers legal and beneficial ownership in financial collateral to a collateral-taker on terms that when the relevant financial obligations are discharged the collateral-taker must transfer legal and beneficial ownership of equivalent financial collateral to the collateral-provider; and
>
> (c) the collateral-provider and collateral-taker are both non-natural persons;"

Considering each of the elements of this definition in turn:

(i) The English Transfer Annex is an arrangement evidenced in writing. The English Transfer Annex is an annex to the Schedule to the ISDA Master Agreement and is expressed to supplement, form part of and be subject to the ISDA Master Agreement. This aspect of the definition is, therefore, satisfied.

(ii) Regarding condition (a) of the definition, the principal purpose of the English Transfer Annex is to provide financial collateral in order to reduce the credit exposure of the collateral-taker to the collateral-provider under the ISDA Master Agreement. In our view, this purpose falls clearly within the words "to secure or otherwise cover the relevant financial obligations owed to the collateral-taker". There are two parts of this definition to consider, namely, the phrase "to secure or otherwise cover" and the phrase "relevant financial obligations owed to the collateral-taker".

(A) The word "secure" in the phrase "to secure or otherwise cover" should be interpreted in a broad commercial sense rather than in the narrower legal sense of creating a security interest. This is clear from the definition viewed as a whole, which makes no mention of the creation of a security interest (leaving aside the words "to secure"), and also sub-clause (b), which sets out the central mechanism of a title transfer financial collateral arrangement without reference to the creation of a security interest. The phrase "to secure or otherwise cover", therefore, plainly means to reduce the credit exposure of the collateral-taker to the collateral-provider by virtue of the obligations owed by the latter to the former under the related ISDA Master Agreement.

(B) The question then arises whether the obligations of the collateral-provider to the collateral-taker under the ISDA Master Agreement are "relevant financial obligations". We have already referred above to the circularity of the definition of "relevant financial obligations" and to our view that this would include obligations owed by the collateral-provider to the collateral-taker under the related ISDA Master Agreement.

As is the case with the Security Documents, the amount of financial collateral to be provided by the collateral-provider under Paragraph 2 to the collateral-taker is determined by reference to the Exposure of the collateral-taker to the collateral-provider under the ISDA Master Agreement. The Exposure is determined in the same manner as is the case under the English Deed.

Condition (a) of the definition is, therefore, satisfied in relation to the English Transfer Annex.

(iii) Regarding condition (b) of the definition, this condition is clearly satisfied by the provisions in Paragraphs 2 and 3 of the English Transfer Annex relating to the transfer between the parties of Eligible Credit Support and Equivalent Credit Support where that Eligible Credit Support or Equivalent Credit Support, as the case may be, is transferred in the form of securities (subject to the paragraph immediately below). Where the Eligible Credit Support or Equivalent Credit Support is in the form of cash, the analysis is less straightforward. Condition (b) would never apply literally to cash collateral as defined in the FCA Regulations. This condition was clearly drafted with financial instruments in mind, the definition of “financial collateral” for purposes of the FCA Regulations being “either cash or financial instruments”. Under a title transfer financial collateral arrangement, cash collateral is transferred to the collateral-taker by payment of an amount of currency, creating a conditional debt owed by the collateral-taker to the collateral-provider, which debt is then available for inclusion within the scope of a “close out netting provision” in the financial collateral arrangement or in an arrangement, such as a master agreement, of which a financial collateral arrangement forms part. The collateral provider does not “transfer[…] legal and beneficial title” to a specific asset previously owned by the collateral provider. Instead, the collateral-taker receives a credit in one of its bank accounts, effected through a payment system, that credit representing a debt owed to the collateral-taker by its bank. The collateral-provider was not the prior “legal and beneficial owner” of that debt. Accordingly, although in the banking system we would refer to the payment of cash as a “transfer” through a payment system, it is not a transfer in the sense used in condition (b) of the definition. Notwithstanding this, we have no doubt, that an English court would give a sensible and purposive interpretation to condition (b) of the definition in relation to financial collateral in the form of cash transferred as Eligible Credit Support or Equivalent Credit Support under Paragraph 2 of the English Transfer Annex. Otherwise, the clear purpose of the FCA Regulations, and indeed of the Collateral Directive, would be defeated in relation to cash collateral under a title transfer financial collateral arrangement.

The term "financial collateral" is defined in the FCA Regulations as being "either cash, financial instruments or credit claims" and "financial instruments" includes "bonds and other forms of instruments giving rise to or acknowledging indebtedness if these are tradable on the capital market". *Prima facie* the Collateral in the form of securities contemplated by our assumption in part III.2 will constitute "financial collateral". However, it is a question of fact whether any particular debt obligation would indeed constitute financial collateral (i.e. being "tradeable on the capital market").

Condition (b) of the definition is, therefore, satisfied in relation to the English Transfer Annex.

(iv) Regarding condition (c) of the definition, a "non-natural person" is "any corporate body, unincorporated firm, partnership or body with legal personality except an individual …". We assume that both parties to the English Transfer Annex are non-natural persons.

Condition (c) of the definition is, therefore, satisfied in relation to the English Transfer Annex.

7. Effects of the FCA Regulations

In relation to a security financial collateral arrangement, the principal effects of the FCA Regulations are:

(a) the elimination of the need of an English Company to register a security financial collateral arrangement as a charge under the registration of charges provisions in Part 25 of the Companies Act 2006 or, in the case of a Foreign Entity that executed a Security Document prior to 1 October 2011, relevant secondary legislation made under the Companies Act 2006 (the **Registration Provisions**);[39]

(b) the elimination of certain doubts that would otherwise apply where the parties have included a right of use in a Security Document (such as under Paragraph 6(c) of the New York Annex);

39 Companies Act 2006 sections 859A and 859H, in relation to a charge executed on or after 6 April 2013 by an English Company, in respect of which see part III below. The position in relation to Foreign Entities is somewhat complicated. The applicable registration regime varies according to whether the charge was created prior to 1 October 2009 (governed by the registration of charges provisions in Part XII of the Companies Act 1985), during the period from 1 October 2009 to 30 September 2011 (governed by the Overseas Companies (Execution of Documents and Registration of Charges) Regulations 2009 SI 2009/1917) or on or after 1 October 2011 (governed by the Overseas Companies (Execution of Documents and Registration of Charges) (Amendments) Regulations 2011 SI 2011/2194 which amended the prior regulations). A charge created prior to 1 October 2009 was registrable under the first regime if it fell within one of the categories of registrable charge, the charged asset was located in England and the entity had, at the time of creation of the charge, an established place of business in England. A charge created between 1 October 2009 and 30 September 2011 was registrable if it fell within one of the categories of registrable charge, the charged asset was located in the United Kingdom and the entity was registered as an "overseas company" with the Registrar of Companies under the Companies Act 2006. A Foreign Entity, whether or not registered as an "overseas company" with the Registrar of Companies, is no longer required to register a charge created on or after 1 October 2011 with the Registrar of Companies. A full discussion of the various regimes applicable to Foreign Entities is outside the scope of this memorandum.

(c) the elimination of the effective prohibition on a Secured Party appropriating the Posted Collateral as a means of realising its security following a default; and

(d) the disapplication of the statutory freeze on enforcement of security that arises in connection with administration proceedings in England.

In relation to a title transfer financial collateral arrangement, the FCA Regulations have less practical effect as English law prior to the coming into effect of the FCA Regulations already reflected the principles in the Collateral Directive to be applied by each EU member state to a title transfer financial collateral arrangement. However, regulation 12 provides on the basis of the assumptions we have made that a close-out netting provision shall take effect in accordance with its terms notwithstanding that the collateral-provider or collateral-taker under the arrangement is subject to winding-up proceedings under the Insolvency Act 1986 or reorganisation measures (i.e. administration, a company voluntary arrangement or an interim order on an administration application). This means that the English Transfer Annex which relies for its effectiveness on the close-out netting provision of Section 6(e) of the ISDA Master Agreement would be protected by regulation 12. This is discussed further in our answer to question 25 below.

The effect of the FCA Regulations on a collateral arrangement governed by each type of Credit Support Document is discussed in more detail below in parts III and IV of this memorandum.

In this memorandum we consider English law as it would apply to a collateral arrangement under a Credit Support Document, both in a case where the FCA Regulations apply and in a case where the FCA Regulations do not apply. We take this approach for the following reasons:

(a) The FCA Regulations are not retrospective in effect, and therefore in relation to a Credit Support Document entered into before 26 December 2003 certain issues (such as whether a Credit Support Document was registrable under the Registration Provisions and, if so, the effect of a failure to register it) may continue to be determined by the law that applied at the relevant time, without regard to the effect of the FCA Regulations.

(b) With some foreseeable variants to the facts assumed in this memorandum (for example, where Collateral used falls outside the definition of "financial collateral" in the FCA Regulations or the collateral arrangement is structured so that the collateral taker under a security financial collateral arrangement does not have "possession or ... control" of the Collateral in the sense required by the FCA Regulations), a collateral arrangement under a Credit Support Document could fall outside the FCA Regulations.

8. Legal basis of the FCA Regulations

In the case of *R (Cukurova Finance International Limited) v HM Treasury*,[40] an attempt was made to challenge the legal basis and therefore validity of the FCA Regulations in the Administrative Court. In *Cukurova*, the claimant argued that the FCA Regulations were invalid due to their implementation being *ultra vires* on the basis that the FCA Regulations exceed the scope of the Collateral Directive in certain respects.[41]

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40 [2008] EWHC 2567 (Admin).

41 See also the case *Oakley Inc. v Animal Limited* [2005] EWCA Civ 1191, 20 October 2005, which considered similar issues outside the context of the financial markets.

The FCA Regulations are subordinate legislation made by the executive branch of government under section 2(2) of the European Communities Act 1972. Section 2(2) allows a designated Minister or government department to make appropriate subordinate legislation for the purpose of implementing an EU directive or other EU obligation requiring implementation in English law.

The FCA Regulations are, in certain respects, wider in scope than the Collateral Directive, most notably in extending the benefits of the regime to financial collateral arrangements between two corporate entities, without the restriction in Article 1(2) of the Collateral Directive that at least one of the parties must fall within one of the other categories enumerated in that Article, namely, a public sector body, central bank, central counterparty or clearing house, or "financial institution subject to prudential supervision" (such as a bank or insurance company) and certain other similar bodies.

The other principal areas in which the FCA Regulations are arguably broader than the Collateral Directive are in relation to (1) the definition of "cash" (the inclusion of "sums due or payable to, or received between the parties in connection with the operation of a financial collateral arrangement or a close-out netting provision", (2) the definition of "financial instruments" in relation to shares (the Collateral Directive appearing to require that shares, as well as bonds, included within this definition should be "negotiable on the capital market", while the FCA Regulations impose no such restriction on shares but require that bonds should be "tradeable on the capital market"[42]) and (3) the definition of "relevant financial obligations" (which is somewhat broader under the FCA Regulations than under the Collateral Directive).

The application in *Cukurova* was rejected on the ground that the application was out of time and that the claimant had failed to establish any of the grounds necessary for the grant of an extension of time. Having reviewed the grounds on which an extension of time could be granted, Moses LJ rejected the claimant's arguments in relation to each of them.

One of the grounds considered by Moses LJ was where a cause is so clearly meritorious that, notwithstanding the hardship of invalidating longstanding legislation, a serious injustice would be done if the application were not heard. This gave Moses LJ the opportunity to review the merits. He ultimately decided that he did not need to express a firm view on the merits, but he indicated why he thought that the claimant's arguments on the merits were doubtful, and therefore to his satisfaction demonstrated that their cause was not clearly meritorious, eliminating this final ground for granting an extension of time in order to hear their application for judicial review.[43]

However, we note in this context the recent comments made *obiter* in the Supreme Court in *The United States of America v Nolan*[44] in relation to the ‘gold-plating’ in the FCA Regulations and the *Cukurova* decision, which raise some doubt about the level of comfort that may be taken from the case. The Supreme Court was of the view that, in relation to the extension of the financial collateral regime to two non-natural persons, it is difficult to see how that could be regarded as having been for the purpose of implementing or enabling the implementation of the Collateral Directive and it was, on its face, a policy decision by HM

42 The FCA Regulations use "tradeable" in preference to the word "negotiable" used in the English language version of the Collateral Directive given the narrow technical meaning of "negotiable" under English law, since clearly a broader concept was intended by the Collateral Directive.

43 For a fuller account of the case and discussion of its implications, see Geoffrey Yeowart, "Validity of the Financial Collateral Regulations" (2008) 2 LFMR 493.

44 [2015] UKSC 63.

Treasury. The *Nolan* case suggested therefore that the FCA Regulations go beyond the scope of the Collateral Directive and may be *ultra vires* in this regard. Although these comments were made *obiter* they raise the possibility of a future challenge to the validity of the FCA Regulations on this point.

If an English court were to take the view that the FCA Regulations are *ultra vires* to the extent that they exceed the scope of the Collateral Directive, we believe that the English court would sever the relevant provisions if and only to the extent that they exceed, in the opinion of the court, the scope of the Collateral Directive.

In this regard, we believe that the court would apply a "substantial severability" test rather than a "textual severability" as discussed by Lord Bridge in his judgment in *DPP v Hutchinson*.[45] Textual severability means, in effect, that a provision is only severable if one could literally or metaphorically run a "blue pencil" through it and the remaining text would nonetheless be coherent and operate effectively without it. Substantial severability permits a court to read and enforce a statute as though rewritten to remove the offending elements, provided that in doing so "it is effecting no change in the substantial purpose and effect of the impugned provision".

Accordingly, we believe that, even if the court were to decide that certain aspects of the FCA Regulations were *ultra vires* for exceeding the scope of the Collateral Directive, the court could and would apply the substantial severability test, which would allow it to continue to give effect to all of the provisions of the FCA Regulations that, narrowly construed, fall within the scope of the Collateral Directive.

As discussed above, on the basis of our assumptions in this memorandum, we are of the view that a financial collateral arrangement entered under a Credit Support Document in connection with an ISDA Master Agreement would fall entirely within a narrow construction of the FCA Regulations assuming that one of the parties was within the scope of the list set out at Article 1(2)(a) - (d) of the Collateral Directive.

In the event that the FCA Regulations were successfully challenged as described above, any arrangement falling outside the scope of the Collateral Directive would lose the protection of the regime, and so for example a security interest may be rendered void by section 859H of the Companies Act 2006 for want of registration in circumstances where the Registration Provisions have not been complied with in reliance on the FCA Regulations.

Partly, we believe, prompted by the concerns raised by the *Cukurova* case, the Banking Act included provisions empowering the Treasury by statutory instrument to, *inter alia*, (i) make regulations regarding financial collateral arrangements[46] and (ii) provide for the FCA Regulations and anything done under or in reliance on the FCA Regulations to be treated as having had effect despite any lack of *vires*. These provisions, if brought into force and used, would provide a statutory basis in primary legislation independent of the constrictions of Article 2(2) of the European Communities Act 1972.[47] We would expect this power to be to

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45 [1990] 2 AC 783

46 The regulations may make any provision necessary to implement the Collateral Directive but the Treasury is expressly not restricted to provision required in connection with the Directive and "may make any provision that the Treasury think necessary or desirable for the purpose of enabling financial collateral arrangements, whether or not with an international element, to be commercially useful and effective."

47 Banking Act, ss 255-256. Note that, under section 256, any regulations under section 255 shall lapse unless approved by resolution of each House of Parliament during the period of 28 days (ignoring periods of dissolution, prorogation or adjournment of either House for more than 4 days) beginning with the day on which the regulations are made. Such a lapse does not invalidate anything done under or in reliance on the regulations before the lapse and at a time when neither House has declined to approve the regulations and does not prevent the making of new regulations (in new terms).

be exercised should a judicial review action concerning the *vires* of the FCA Regulations be successful.

III. SECURITY INTEREST

1. Introduction

In this part III we consider issues relating to the creation, perfection, and enforcement against an English Company of a security interest created in respect of Collateral delivered under each of the Security Documents under fact patterns (a) and (b) as set out in part I.4 of this memorandum.

Our conclusions in this respect in relation to an English Company apply in relation to:

(a) an English Bank, as modified and supplemented by Annex 1;

(b) an English Investment Firm, as modified and supplemented by Annex 2;

(c) an English Building Society, as modified and supplemented by Annex 3;

(d) a Banking Group Company or Bank Holding Company, as modified and supplemented by Annex 4;

(e) the Trustee of an English Trust (other than the Trustee of an English Charitable Trust, an English Authorised Unit Trust or any English Trust excluded from the scope of this memorandum under part I.2(b) above), as modified and supplemented by Annex 5;

(f) a Friendly Society, as modified and supplemented by Annex 6;

(g) a C/CB Society, as modified and supplemented by Annex 7;

(h) a Statutory Corporation, as modified and supplemented by Annex 8;

(i) a Chartered Corporation, as modified and supplemented by Annex 9;

(j) an English Insurance Company, as modified and supplemented by Annex 10;

(k) Standard Chartered Bank, as modified and supplemented by Annex 11;

(l) an English Charity acting through the Trustee of an English Charitable Trust, as modified and supplemented by Annex 12;

(m) an English Charity established in one of the other forms indicated above, as modified and supplemented by Annex 13;

(n) an English Investment Fund that is an Open-Ended Investment Company, as modified and supplemented by Annex 14; and

(o) an English Investment Fund acting through the Trustee of an Authorised Unit Trust, as modified and supplemented by Annex 15.

You have also asked us to consider such issues in respect of the Bank of England, which is a Central Bank and requires separate analysis given its unique nature.

This part III does not apply in respect of the United Kingdom acting through Her Majesty's

Treasury.

In this part III we also consider issues relating to the creation, perfection and enforcement of a security interest created in respect of Collateral delivered under each of the Security Documents by a Foreign Entity where the Collateral is located in England under fact pattern (c) as set out in part I.4 of this memorandum.

2. Assumptions

For the purpose of this part III, in addition to the assumptions set out at part I.3, you have asked us to make the following assumptions:

(a) The Security Collateral Provider has entered into an ISDA Master Agreement and a Security Document with a Secured Party. The parties have entered into either (i) an ISDA Master Agreement governed by New York law and a New York Annex, or (ii) an ISDA Master Agreement governed by English law and an English Deed.

(b) Although each Security Document is a bilateral form in that it contemplates that either party may be required to post Collateral to the other depending on movements of exposure under the relevant Security Document, we assume, for the sake of simplicity, that the same party is the Security Collateral Provider at all relevant times under the applicable Security Document.

(c) We assume that each party is either an English Company or a Foreign Entity as defined above.

(d) If the ISDA Master Agreement is governed by New York law, the ISDA Master Agreement and related New York Annex would, when duly entered into, constitute legal, valid and binding obligations of each party under New York law.

(e) No provision of the ISDA Master Agreement or relevant Security Document has been altered in any material respect. The making of standard elections in Paragraph 13 of either Security Document (consistently with the other assumptions in this memorandum) would not in our view constitute material alterations, except where expressly indicated in the discussion below.

(f) Pursuant to the Security Document, the counterparties agree that Eligible Collateral will include cash credited to an account (as opposed to physical notes and coins) and certain types of securities (as further described below) that are located or deemed located either (i) in England or (ii) outside England.

(g) Any securities provided as Eligible Collateral consist of debt securities issued by (i) the government of the United Kingdom (commonly referred to as "UK Government Stock", "gilt-edged securities", or "gilts"), (ii) the government of another member of the so-called "G-10" group of leading industrialised countries, (iii) an English Company, (iv) a Foreign Entity, (v) a Supranational Entity (as defined in the Collateral Asset Definitions, as published by ISDA) or (vi) the government of a sovereign country, in one of the following forms:[48]

48 Article 3(2) of Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories (the **CSDRs**) suggests that where 'transferable securities' are transferred pursuant to a financial collateral arrangement (as defined in the Collateral Directive) those securities must be in book-entry form in a CSD. The full implications of this provision are not clear but, in addition to the obvious application to title transfer financial collateral arrangements such as the English Transfer Annex, it is possible that this requirement in the CSDRs could also have implications in relation to a security financial collateral arrangement, such as the

(i) directly held bearer debt securities: by this we mean debt securities issued in certificated form in bearer form (meaning that ownership is transferable by delivery of possession of the certificate) and, when held by a Secured Party as Collateral under a Security Document, held directly in this form by the Secured Party (that is, not held by the Secured Party indirectly with an Intermediary (as defined below));

(ii) directly held registered debt securities: by this we mean debt securities issued in registered form and, when held by a Secured Party as Collateral under a Security Document, held directly in this form by the Secured Party so that the Secured Party is shown as the relevant holder in the register for such securities (that is, not held by the Secured Party indirectly with an Intermediary);

(iii) directly held dematerialised debt securities: by this we mean debt securities issued in dematerialised form and, when held by a Secured Party as Collateral under a Security Document, held directly in this form by the Secured Party so that the Secured Party is shown as the relevant holder in the electronic register for such securities (that is, not held by the Secured Party indirectly with an Intermediary);

(iv) indirectly held debt securities: by this we mean a form of interest in debt securities recorded in fungible book-entry form in an account maintained by a financial intermediary (which could be a central securities depositary (**CSD**) or a custodian, nominee or other form of financial intermediary, in each case an **Intermediary**) in the name of the Secured Party where such interest has been credited to the account of the Secured Party in connection with a transfer of Collateral by the Security Collateral Provider to the Secured Party under a Security Document. [49]

The financial intermediary in such a holding pattern will either itself hold the underlying security directly (for example, in certificated bearer or registered form (which securities may be 'immobilised'), or dematerialised form) or indirectly through a chain (composed of one or more **tiers**) of other financial intermediaries (sub-custodians). At the top of the multi-tiered holding structure,[50] the underlying security would typically be held by a financial intermediary or other person in certificated bearer, registered, or dematerialised form in a direct relationship with the issuer of the security.

(h) Any cash Collateral provided under the Security Document is denominated in a freely convertible currency and is held in an account under the control of the Secured Party.

English Deed or New York Annex, where the nature of the security interest effects a 'transfer' of the transferable securities. As a matter of English law this would be the case where a legal mortgage over those securities is taken and could, in theory, also include an equitable mortgage. As the CSDRs provide, at Article 8(3), that an infringement of Article 3(2) shall not affect the validity of the relevant contract, we do not consider the CSDRs further in this memorandum. However, ISDA members should be aware that failure to comply could result in liability for regulatory breach.

49 Indirectly held securities are often referred to as "intermediated" securities. The terms are interchangeable. In this memorandum for clarity we use only the term "indirectly held".

50 It has become conventional in the international literature on indirectly held securities to apply a vertical metaphor to these holding patterns, so that "upper-tier" intermediaries are considered to be closer to the intermediary or other person in a direct relationship with the issuer of the relevant security while "lower-tier" intermediaries are closer to the financial intermediary with a direct relationship with the ultimate holder of the interest. We follow this convention in this memorandum.

(i) Pursuant to the ISDA Master Agreement, the Security Collateral Provider enters into a number of Transactions with the Secured Party. Such Transactions include only Transactions of a type falling within one or more of the types of transaction described in Appendix A.

(j) In the case of questions 12 to 15 below, that after entering into the Transactions and prior to the maturity thereof, an Event of Default or Specified Condition exists and is continuing with respect to the Security Collateral Provider, in the case of the New York Annex, or a Relevant Event or Specified Condition exists and is continuing with respect to the Security Collateral Provider, in the case of the English Deed, and/or, in either case, an Early Termination Date has occurred or been designated as a result thereof (however, an insolvency proceeding has not been instituted).

(k) In the case of questions 16 to 18 below, that an Event of Default under Section 5(a)(vii) of the ISDA Master Agreement with respect to the Security Collateral Provider has occurred and a formal bankruptcy, insolvency, liquidation, reorganisation, administration or comparable proceedings (collectively, **insolvency proceedings**) have been instituted in respect of the Security Collateral Provider. In addition we assume that, upon the commencement of insolvency proceedings in respect of the Security Collateral Provider, the Secured Party seeks to enforce the financial collateral arrangement constituted by the relevant Security Document in accordance with its terms and that no further collateral will be delivered to the Secured Party. We make this assumption because any disposition of an insolvent party's property made after the commencement of the winding up is, unless the court orders otherwise, void: section 127 of the Insolvency Act 1986. The court has the discretion to validate a disposition if it was made honestly in the ordinary course of business and prior to the winding up order being made.

3. Questions relating to the Security Documents

Validity of Security Interests: Creation and Perfection

1. *Under the laws of your jurisdiction, what law governs the contractual aspects of a security interest in the various forms of Eligible Collateral deliverable under the Security Documents? Would the courts of your jurisdiction recognise the validity of a security interest created under each Security Document assuming it is valid under the governing law of such Security Document?*

Under English law, the law governing the contractual aspects of a security interest in the various forms of Eligible Collateral identified above is the governing law of the relevant Security Document. By 'contractual' in this context we mean the personal rights and obligations of the Collateral Provider and Collateral Taker.

Assuming that the choice of law in the relevant Security Document is a valid and proper choice of law, the English courts would recognise the validity of the contractual aspects of a security interest created under a Security Document if that security interest was valid under the governing law of the Security Document.

See our answer to question 19 below in respect of whether the choice of law would be respected by the English courts.

2. *Under the laws of your jurisdiction, what law governs the proprietary aspects of a security interest (that is, the formalities required to protect a security interest in Collateral against*

competing claims) granted by the Security Collateral Provider under each Security Document (for example, the law of the jurisdiction of incorporation or organisation of the Security Collateral Provider, the jurisdiction where the Collateral is located, or the jurisdiction of location of the Secured Party's Intermediary in relation to Collateral in the form of indirectly held securities)? What factors would be relevant to this question? Where the location (or deemed location) of the Collateral is the determining factor, please briefly describe the principles governing such determination under the law of your jurisdiction with respect to the different types of Collateral. In particular, please describe how the laws of your jurisdiction apply to each form in which securities Collateral may be held as described in assumption (g) above.

Under English rules of private international law, the law applicable to the proprietary aspects of a transfer (including transfer by way of security) of a tangible asset is the law of the place where the tangible asset is located (the *lex situs*).[51] This is a longstanding rule, no doubt founded on the simple policy that the courts of the place where a species of property is located, whether it is real or personal property, is best placed to determine its legal nature and the rights and obligations of persons dealing with it. Each type of Collateral with which we are concerned is, however, an intangible asset in the form of a claim.[52]

Strictly speaking, a claim has no location, and therefore it is necessary to consider the nature of the claim in order to determine which law applies to the proprietary aspects of a transfer of that claim. This has led to some uncertainty and academic debate in relation to the appropriate analysis in relation to certain types of claim, for example, the claim represented by an indirectly held debt security.

There are two main approaches to determining the law that governs the proprietary effect of transactions involving intangible assets: (a) the law of the place where the intangible asset is located at the time of the transaction (the *lex situs*)[53]; or (b) the law which governs the intangible asset (i.e. the law that governs the contract that created the intangible asset).[54]

Dicey's Rule 135 currently provides (1) as a general rule the mutual obligations of an assignor and assignee are governed by the law of the contract between them and the law governing the right to which the assignment relates determines its assignability, the relationship between the assignee and the debtor, the conditions under which the assignment can be invoked against the debtor and any question as to whether a debtor's obligations have been discharged and (2) in other cases the validity and effect of an assignment of an intangible may be governed by the law with which the right assigned has its most significant connection.[55]

Article 14(2) of Rome I[56] also follows the position currently adopted by *Dicey*. Whilst some

51 Lawyers from the civil code tradition prefer the term "*lex rei sitae*", which is why the term appears in the heading of certain articles in EU Directives dealing with these matters, as discussed in more detail below.

52 As discussed below, a directly held bearer debt security has a tangible manifestation, although it represents an intangible claim.

53 As intangible assets by definition do not have a natural *lex situs*, this involves deeming *lex situs* for this purpose. We discuss below how, in our view, *lex situs* would be determined in the context of intangibles, where relevant. Broadly speaking, however, there are two approaches. The first and more traditional approach is to attempt to identify a physical manifestation of the intangible claim, such as a certificate representing the claim or a physical register in which the interest is recorded, and then to ascribe a fictional 'location' to the claim by reference to the physical manifestation. The *lex situs* is then identified as the law of the place of the location of the physical manifestation. The more modern approach, taken in relation to dematerialised and indirectly held debt securities, seeks to consider the nature of the claim in its commercial context and to identify the rule that best meets the commercial expectations of the parties to a transaction dealing with that claim and protects third parties with a legitimate interest in the claim.

54 For a fuller discussion of the issues see H. Beale and others, *The Law of Security and Title-Based Financing*, (2nd edition, OUP 2012), ch 22, and R. Calnan, *Taking Security*, (Third Edition Jordans, Bristol 2013), ch 13.

55 *Dicey, Morris & Collins on the Conflict of Laws* (Fifteenth edition 2012), chapter 24.

56 Regulation 593/2008 of 17 June 2008 on the law applicable to contractual obligations.

commentators have been of the view that the Rome Convention and Rome I do not cover proprietary questions, the Court of Appeal in the leading case of *Raiffeisen Zentralbank Österreich v Five Star Trading*[57] (which was decided in relation to the equivalent provision of the Rome Convention) confirmed that Article 14(2) provides that the rights of an assignee (and by extension a chargee) of most types of intangible asset are determined by the law governing that asset and not by its *lex situs*. One of the key arguments for this approach is that the *lex situs* of an intangible is generally the country in which it is properly recoverable or can be enforced but this is often uncertain and may result in an artificial determination of *lex situs*.

On the basis of the above, in respect of the English Deed assuming that the security interest in the cash is characterised as a chargeback of the debt owed by the Secured Party (being the contingent obligation to transfer a Return Amount) then the relevant law would be English law (being the governing law of the English Deed which governs the debt). In respect of the New York Annex, the precise nature of the security interest over the underlying asset is a question of New York law. On the basis of the above discussion, from an English law perspective, the relevant law that governs the proprietary aspects of the security interest under the New York Annex will be the law that governs the creation of the underlying interest of the Security Collateral Provider in the cash which is secured in favour of the Secured Party.

However, the position is less straightforward in respect of securities and *Dicey* also accepts that a different analysis may be called for in respect of securities, particularly immobilised and dematerialised securities.[58] For example, title to a bearer bond passes by physical delivery of the certificate unlike other intangibles and a bearer bond may be a negotiable instrument. Article 1 (2)(d) of Rome I excludes from its scope obligations ‘other negotiable instruments to the extent the obligations under such other negotiable instruments arise out of their negotiable character’. *Macmillan v Bishopsgate Investment Trust*[59] suggests that the proprietary effect of a transfer of shares is governed by the *lex situs*, however, the Court of Appeal was not in complete agreement as to how to determine *lex situs* for these purposes. Broadly two options were contemplated: (i) the place of incorporation of the company relating to the shares in question, or (ii) the place where the register is kept.

It has been suggested that, in the context of securities, general conflict of law principles look to the place of the root of title (i.e. the best evidence of title).[60] This, in our view, is akin to the *lex situs* approach. If this approach is applied we believe the relevant law would be in respect of (i) a directly held dematerialized debt security, the law of the jurisdiction establishing the statutory regime under which such dematerialized debt securities are issued or, if different, the law of such other jurisdiction as is specified in that statutory regime to govern the proprietary aspects of transfers of such securities; (ii) a directly held bearer debt security is the place the certificate is located in;[61] and (iii) a directly held registered debt securities is the place in which the register is located.[62]

In the case of indirectly held debt securities, there will frequently be a chain (or tiers) of intermediaries holding the "same" security or, more accurately, recording an interest in the security on their records in favour of the next intermediary down the chain down to the ultimate holder. The general rule in such circumstances is to look to the place of the account,

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57 [2001] EWCA Civ 68.

58 *Dicey*, op cit, paragraph 24-071.

59 [1996] 1 WLR 387.

60 See discussion in Gullifer L, *Goode on Legal Problems of Credit and Security*, (Fifth edition, Sweet & Maxwell 2013), para 6-21.

61 *Attorney-General v Bouwens* (1838) 4 M&W 171.

62 *Attorney-General v Higgins* (1857) 2 H&N 339.

register or other recording in book-entry form of the most immediate intermediary regardless of where other links in the chain may be located (e.g. the immediate intermediary's own custodian, the custodian's custodian and so on). This rule is sometimes referred to as the "place of the relevant intermediary approach" or "PRIMA". This approach also accords with the general principle of looking to the place of the root of title as the root of title is the securities account with the intermediary.

The PRIMA approach applies under English law in various contexts by virtue of the implementation of the Settlement Finality Directive,[63] the Winding Up Directive[64] and the Collateral Directive.[65] The implementation of the latter Directive is particularly significant in this regard. In the case of financial collateral arrangements under the FCA Regulations, regulation 19 of the FCA Regulations provides that, where book entry securities are used as collateral and are held through one or more intermediaries, any question relating to the matters specified in paragraph (4) of the regulation shall be governed by the domestic law of the country in which the relevant account is maintained. The matters referred to in paragraph (4) include "the legal nature and proprietary effects of book entry securities collateral" as well as the requirements for perfection and the rules of priority. Accordingly, if, as discussed at part II above, the Security Document is a financial collateral arrangement for the purposes of the FCA Regulations, it is clear that PRIMA is the relevant approach to be taken in respect of such securities to ascertain the law governing the proprietary aspects of the security interest.

Outside these contexts, there is no statutory basis for the PRIMA approach in English law and relatively little relevant case law, however, we believe that if an English court were called upon to determine the correct rule to apply to the proprietary aspects of security over indirectly held securities outside these contexts, it is likely to conclude that PRIMA is the correct general approach as it is supported by logic, common sense and commercial practicality, as well as a growing body of authoritative commentary.[66]

Note that the rules above are general guidelines. The determination in any specific case will depend on the relevant facts.

It is important to bear in mind that, *in addition* to any perfection requirements in the relevant jurisdiction in respect of the asset, the Registration Provisions will also apply in respect of an English Company in circumstances where, for whatever reason, the FCA Regulations do not apply to the Security Documents. The Registration Provisions are described in the answer to question 5 below.

Note that the EC Insolvency Regulation contains its own rules for determining the 'location' of the Collateral for certain purposes – see the discussion at question 20 for more details.

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63 EC Directive 98/26 on settlement finality in payment and securities settlement systems, art 9(2). The Financial Markets and Insolvency (Settlement Finality) Regulations 1999, SI 1999/2979 (the **Settlement Finality Regulations**) implemented the Settlement Finality Directive. See regulation 23 of the Settlement Finality Regulations in respect of the PRIMA approach. Note that the definition of "collateral security" in regulation 2 makes it clear that the scope of regulation 23 is limited to collateral arrangements arising "in connection with participation in a designated system" or, when given to a central bank "in connection with its operations . . . as a central bank". Accordingly, the United Kingdom has implemented the Settlement Finality Directive on a narrow basis, in contrast to the position in many other member states of the European Union.

64 Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the reorganisation and winding up of credit institutions (the **Winding Up Directive**), art 24. The Credit Institutions (Reorganisation and Winding Up) Regulations 2004 (SI 2004/1045) (the **Winding Up Regulations**) implemented the Winding Up Directive in England. See regulation 33 of the Winding Up Regulations in respect of the PRIMA approach in this context.

65 Collateral Directive, art 9.

66 See, for example, the discussion in *Dicey, Morris & Collins on the Conflict of Laws*, at paragraph 24-072. See also the proceedings of the Oxford Colloquium on Collateral and Conflict of Laws, held at St John's College, Oxford University in May 1998, published as a special supplement to Butterworths Journal of International Banking and Financial Law, September 1998. See also Gullifer L, *Goode on Legal Problems of Credit and Security*, (Fifth edition, Sweet & Maxwell 2013).

3. *Would the courts of your jurisdiction recognise a security interest in each type of Eligible Collateral created under each Security Document? In answering this question, please bear in mind the different forms in which securities Collateral may be held, as described in assumption (g) above. Please indicate, in relation to cash Collateral, if your answer depends on the location of the account in which the relevant deposit obligations are recorded and/or upon the currency of those obligations.*

In our opinion the English courts would recognise a security interest in each type of Eligible Collateral created under each Security Document, provided the security interest was valid under the governing law of the Security Document (if not English law) and provided also that any applicable requirements, including as to perfection, under the relevant proprietary law in relation to the Eligible Collateral (determined in accordance with the rules of English private international law, as to which see the answer to question 2 above) had been complied with. In respect of the right of use, see question 10 below.

In respect of securities, the English Deed refers to the securities being mortgaged, charged and pledged. It is unlikely as a technical matter that intangible securities would be subject to a pledge as pledges require possession which is problematic in relation to intangible assets. However, it is clear that a security interest has been created and the precise terminology used is of less importance as the court is able to determine that the clear purpose of the parties is to create a security interest.[67] We assume for these purposes that the Secured Party complies with its obligations under Paragraph 6(c) of the English Deed in respect of the segregation of non-cash Posted Collateral.

Under the English Deed, in the case of cash collateral, there is a transfer of title (there is no obligation to segregate the cash collateral from the Secured Party's own funds) and a chargeback to the Secured Party of the debt owed by it to the Security Collateral Provider in respect of the cash. Historically following the decision in *Re Charge Card Services Limited*[68] there was doubt about the ability of a bank to take a charge over its own indebtedness but this was, in effect, overruled by the decision of the House of Lords in *Morris v Agrichemicals Limited.*[69] Accordingly, there is no longer any significant doubt under English law that a security interest may be taken over cash deposited with the Secured Party to secure a debt owed to the Secured Party.

The location of, and governing law of, the account in which the relevant deposit obligations are recorded is not directly relevant to the question of recognition. The currency of those obligations is not relevant to the question of recognition.

4. *What is the effect, if any, under the laws of your jurisdiction of the fact that the amount secured or the amount of Eligible Collateral subject to the security interest will fluctuate under the ISDA Master Agreement and the relevant Security Document (including as a result of entering into additional Transactions under the ISDA Master Agreement from time to time)? In particular:*

   (a) would the security interest be valid in relation to future obligations of the Security Collateral Provider?

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67 For example, see paragraphs 39 to 48 of *Re Lehman* where the security interest in that case was characterised as a charge.

68 [1986] 3 All ER 289.

69 [1997] 4 All ER 568, *sub nom. Re Bank of Credit & Commerce International SA (No 8).* The statement by the House of Lords overruling *Charge Card* is, strictly speaking, *obiter dictum*. For various reasons, we believe that it may be relied upon as a statement of the current law on the effectiveness of a charge-back.

(b) *would the security interest be valid in relation to future Collateral (that is, Eligible Collateral not yet delivered to the Secured Party at the time of entry into the relevant Security Document)?*

(c) *is there any difficulty with the concept of creating a security interest over a fluctuating pool of assets, for example, by reason of the impossibility of identifying in the Security Documents the specific assets transferred by way of security?*

(d) *is it necessary under the laws of England for the amount secured by each Security Document to be a fixed amount or subject to a fixed maximum amount?*

(e) *is it permissible under the laws of England for the Secured Party to hold Collateral in excess of its actual exposure to the Security Collateral Provider under the related ISDA Master Agreement?*

As a matter of English law there are no adverse consequences arising from the fact that the amount secured or the amount of Eligible Collateral subject to the security interest will fluctuate under the ISDA Master Agreement and the relevant Security Document, provided it does so in accordance with the terms agreed between the parties.

Subject to the foregoing, in answer to the specific questions on this point:

(a) Yes, provided that the future obligations are able to be identified with certainty as and when they arise, by reference to the terms of the Security Document (which will include future obligations arising under Section 6 of the ISDA Master Agreement). Of course, until future obligations of the Security Collateral Provider become present obligations of the Security Collateral Provider, the Secured Party is not able to enforce its Collateral and apply the results of such enforcement to discharge those obligations. It is possible, however, for the Security Collateral Provider and the Secured Party to agree that obligations arising in the future will be secured by Collateral given presently (or in the future, but regarding this see our response (b) below) without any further action by either party. In other words, future obligations become secured obligations as and when they become present obligations without any further act by the parties, provided that they are obligations of a sort clearly contemplated by the terms of the relevant Security Document. Any obligations arising under an ISDA Master Agreement (including under any Transaction) would clearly be contemplated by the terms of either of the Security Documents, on the assumptions we have made.

(b) Yes, provided that the future Collateral is able to be ascertained as and when it is provided as Collateral. Of course, until the relevant Collateral has been provided under the terms of the relevant Security Document, no present security interest has been created in any specific assets. By saying that a "security interest is valid in relation to future Collateral", we simply mean that a security interest arises in Collateral delivered after the date of execution of the relevant Security Document as and when the Collateral is delivered without any further action by either party, other than, of course, the provision of the Collateral and satisfaction of any perfection requirements in the locations discussed in our answer to question 2. No new grant of security, however, is necessary. The original Security Document is sufficient in this respect for both Collateral provided (if any) at the time of execution of the Security Document and any Collateral provided in the future.

(c) No, provided that the pool of assets over which the security interest is to be created is identified with sufficient clarity so that the Collateral may be identified with sufficient certainty at any given time.

(d) No.

(e) Yes, provided that it has been agreed by the parties that such excess Collateral may be held.

5. *Assuming the courts of your jurisdiction would recognise the security interest in each type of Eligible Collateral created under each Security Document, is any action (filing, registration, notification, stamping, notarization or any other action or the obtaining of any governmental, judicial, regulatory or other order, consent or approval) required in your jurisdiction to perfect that security interest? If so, please indicate what actions must be taken and how such actions may differ depending upon the type of Eligible Collateral in question?*

To perfect a security interest is to take the necessary steps to ensure the validity of the security interest as against third parties, such as a liquidator, administrator, creditor, or competing claimant to specific assets included in Eligible Collateral delivered to the Secured Party.

The steps necessary to perfect a security interest depend upon a number of factors, including the type of security interest created (mortgage, charge, pledge, contractual lien), the nature and/or location of the assets in which the security interest is created, and the nature and/or location of the grantor of the security interest.

On the assumptions we have been asked to make for purposes of this memorandum, the only perfection requirement that may be relevant in some cases to a Security Document is the requirement under the Registration Provisions to register charges created by an English Company (in addition to any perfection requirements in the relevant jurisdiction in respect of the asset).

One of the principal effects of the FCA Regulations is to disapply the Registration Provisions in relation to security financial collateral arrangements. We have discussed the FCA Regulations at part II above and any Security Document that constitutes or forms part of a security financial collateral arrangement will not require registration, even if otherwise registrable in accordance with the principles discussed below.[70]

Where, however, a Security Document falls outside the FCA Regulations and an English Company is a party to the Security Document, it is important to register. Failure to register a registrable charge within the prescribed period will result in (a) the Security Document becoming void (as far as any security is created by it) against a liquidator, administrator or creditor of the Security Collateral Provider and (b) any obligations secured by the Security Document becoming immediately payable.[71]

(1) <u>Registration Provisions</u>

We discuss below the Registration Provisions that apply to charges created by English Companies on or after 6 April 2013. Security Documents executed prior to 6 April 2013 would have had to comply with the provisions applicable at the date of

70 FCA Regulations, regulation 4.

71 Companies Act 2006 s 859H. It is not clear, however, how the acceleration would apply in practice to the contingent obligations of the Security Collateral Provider under the related ISDA Master Agreement.

execution of the Security Document.

Since 6 April 2013, any charge created by an English Company (but not a Foreign Entity) is registrable under the Registration Provisions (subject to limited exceptions of which the most important is a financial collateral arrangement as discussed above).[72] The term "charge" for these purposes includes mortgages,[73] including security interests governed by a foreign law that would be characterised for English law purposes as a mortgage or charge. In our view, the security interest created by the New York Annex would be characterised by an English court as a mortgage or charge of Eligible Collateral delivered by the Security Collateral Provider to the Secured Party, and therefore the Registration Provisions apply to the New York Annex in the same manner, and subject to the same conditions, as they apply to the English Deed.

The basic requirement of the Registration Provisions in respect of English Companies is that the statement of particulars and a certified copy of the charging instrument must be delivered to the Registrar of Companies within 21 days of creation.[74]

The Registrar of Companies is a government official in the United Kingdom with various statutory responsibilities relating to English Companies.[75] The particulars of the charge are to be set out on Form MR01, which is published by the Registrar of Companies.

The consequences of failure to present a registrable charge to the Registrar of Companies for registration within 21 days after the creation of the charge are that:

(i) the charge is void against a liquidator or administrator of the company creating the charge and against any creditor of the company; and

(ii) the liabilities secured by the charge become immediately payable (although how this latter consequence would apply to the ISDA Master Agreement is not clear).

A certificate of registration issued by the Registrar of Companies constitutes conclusive evidence that the requirements of the relevant part of the Companies Act as to registration have been satisfied. This means that the registration cannot be challenged, even if it subsequently appears that there was an error in the completion of Form MR01 setting out the particulars of the charge or even where the registration was, in fact, made out of time.[76]

Registration does not *per se* establish the priority of a security interest. In certain circumstances, however, a registration or failure to register can affect the priority of a registrable charge where a priority question turns on the question of notice. Historically valid registration was not thought to serve as constructive notice of the detailed provisions of a security document.[77] However, following recent reforms, the

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72 Companies Act s859A. In respect of Foreign Entities, see note 39 above.

73 Companies Act 2006 s 859A(7).

74 Companies Act 2006 ss 859A to 859H.

75 The Registrar of Companies maintains various offices throughout the United Kingdom. These offices are collectively (and severally) referred to as "Companies House". Hence, informally, one often speaks of registering a charge at Companies House.

76 *Re CL Nye Ltd* [1971] Ch 442, CA. In practice, of course, the Registrar will reject an application to register made out of time, so this route cannot be counted on as a way of "curing" a failure to register in time. See further discussion of this point below.

77 *Wilson v Kelland* [1910] 2 Ch 306.

statement of particulars includes whether the charge contains a negative pledge and a copy of the charge is also available. It may therefore follow that at least some of the details of the charge are potentially within scope of constructive knowledge.

If a charge is not registered within the relevant 21-day period or if the details provided on Form MR01 are wrong or incomplete, registration may only be effected or the details rectified by obtaining a court order. The court will only issue such an order if it is satisfied that the failure to register in time was "accidental, or due to inadvertence or some other sufficient cause, or is not of a nature to prejudice the position of creditors or shareholders of the company, or that on other grounds it is just and equitable to grant relief".[78] In practice, the court is normally reluctant to issue such an order.

Once a charge has been registered under the Registration Provisions, no further registration or renewal of the registration is needed while the charge remains in effect.

(2) Registrability of the Security Documents

In light of the foregoing discussion, any Security Document that is not a Security Financial Collateral Arrangement would be registrable in respect of an English Company.

6. *If there are any other requirements to ensure the validity or perfection of a security interest in each type of Eligible Collateral created by the Security Collateral Provider under each Security Document, please indicate the nature of such requirements. For example, is it necessary as a matter of formal validity that the Security Document be expressly governed by the law of your jurisdiction or translated into any other language or for the Security Document to include any specific wording? Are there any other documentary formalities that must be observed in order for a security interest created under each Security Document to be recognized as valid and perfected in your jurisdiction?*

There are no particular additional requirements or formalities to ensure the validity or perfection of a security interest in relation to each type of Eligible Collateral that may be delivered under a Security Document. It is not necessary as a matter of formal validity that a Security Document be expressed to be governed by English law. As the Security Documents are drafted in the English language, the question of translation does not arise. No specific form of words is necessary to create a security interest under English law as long as the intention to create a security interest is clear from the terms of the document and other relevant circumstances. The Security Documents are sufficiently clear in this regard (we assume, for these purposes, that such intention is clear as a matter of New York law in respect of the New York Annex).

7. *Assuming that Party B has obtained a valid and perfected security interest in the Eligible Collateral under the laws of your jurisdiction, to the extent such laws apply, by complying with the requirements set out in the responses to questions 1 to 6 above, will the Secured Party or the Security Collateral Provider need to take any action thereafter to ensure that the security interest in the Eligible Collateral continues and/or remains perfected, particularly with respect to additional Collateral pledged from time to time whenever the Credit Support Amount exceeds the Value of the Collateral held by the Secured Party?*

[78] Section 859F of the Companies Act 2006.

No additional actions of this kind will be required.

8. *Assuming that (a) pursuant to the laws of your jurisdiction, the laws of another jurisdiction govern the creation and/or perfection of a security interest in the Eligible Collateral pledged pursuant to each Security Document and (b) the Secured Party has obtained a valid and perfected security interest in the Eligible Collateral under the laws of such other jurisdiction, will the Secured Party have a valid security interest in the Collateral so far as the laws of your jurisdiction are concerned? Is any action (filing, registration, notification, stamping or notarization or any other action or the obtaining or any governmental, judicial, regulatory or other order, consent or approval) required under the laws of your jurisdiction to establish, perfect, continue or enforce this security interest? Are there any other requirements of the type referred to in question 6 above?*

As discussed in the answer to question 5 above, unless disapplied by the FCA Regulations, the Registration Provisions apply to English Companies, irrespective of where the Eligible Collateral is located or the governing law of the relevant Security Document.[79] There are no other requirements of the type referred to in question 6.

9. *Are there any particular duties, obligations, or limitations imposed on the Secured Party in relation to the care of the Eligible Collateral held by it pursuant to each Security Document?*

Under English law the Secured Party is under an obligation established by case law to take reasonable steps to ensure the safe custody of any charged property in its possession. Secured Parties that are regulated entities may also be subject to regulatory duties.

10. *Please note that pursuant to the terms of the English Deed, the Secured Party is not permitted to use any Collateral securities it holds. This is because it is thought, as a matter of English law, that any such use is or may be incompatible with the limited nature of the interest that the Secured Party has in the Collateral. On the other hand, unless otherwise agreed to by the parties, Paragraph 6(c) of the New York Annex grants the Secured Party broad rights with respect to the use of Collateral, provided that it returns equivalent Collateral when the Security Collateral Provider is entitled to the return of Collateral pursuant to the terms of the New York Annex. Such use might include pledging or rehypothecating the securities, disposing of the securities under a securities repurchase (repo) agreement or simply selling the securities. Do the laws of your jurisdiction recognize the right of the Secured Party so to use such Collateral pursuant to an agreement with the Security Collateral Provider? In particular, how does such use of the Collateral affect, if at all, the validity, continuity, perfection or priority of a security interest otherwise validly created and perfected prior to such use? Are there any other obligations, duties or limitations imposed on the Secured Party with respect to its use of the Collateral under the laws of your jurisdiction?*

As noted briefly above, one of the principal effects of the FCA Regulations in relation to security financial collateral arrangements is to eliminate certain doubts that would otherwise apply where the parties have included in a Security Document (such as under Paragraph 6(c) of the New York Annex) the right of the Secured Party to dispose of or otherwise use relevant Posted Collateral. Specifically, regulation 16(1) of the FCA Regulations provides that "[i]f a security financial collateral arrangement provides for the collateral-taker to use and dispose of any financial collateral provided under the arrangement, as if it were the owner of it, the collateral-taker may do so in accordance with the terms of the arrangement".

79 In relation to Foreign Entities, see note 39.

Accordingly, the English Deed could be amended to provide that the Secured Party has the right (a **Right of Use**) to deal with the Collateral provided under the English Deed as though it were the owner.

In the case of Paragraph 6(c) of the New York Annex, the validity of the Right of Use will be governed by New York law, and we do not believe there is any reason in principle why an English court would seek to interfere with such an arrangement if it is valid as a matter of New York law, subject to the discussion herein of the effect of regulation 16 of the FCA Regulations.[80]

In relation to the English Deed, if parties are going to include a Right of Use, they will still need to draft the Right of Use carefully to ensure that the consequences of this inclusion are clear. For this reason, and also to address any case where, for whatever reason, a Security Document falls outside the FCA Regulations, we believe it may be helpful to set out the issues that have traditionally been considered to be raised by the inclusion of a Right of Use in a mortgage or charge.

As a matter of English law, the inclusion in a mortgage or charge of a Right of Use,[81] including the right to sell or charge the securities to a third party, has traditionally been considered inconsistent with the limited nature of a security interest. (The more specific objection that such a clause would constitute a "clog on the equity of redemption" is discussed below.)

The security interest of a Secured Party is a proprietary interest in favour of the Secured Party created out of the ownership interest of the Security Collateral Provider in the relevant Collateral. Permitting the Secured Party to deal with security assets as though they were the outright property of the Secured Party is therefore, at least *prima facie*, conceptually inconsistent with the limited nature of a security interest.

In practical terms, once the Security Collateral Provider ceases to own the security assets (or, more accurately, ceases to have an equity of redemption in those assets), the Secured Party's interest must also disappear, unless the third party purchaser of those assets agrees to purchase the assets subject to the security interest. In practice, this does not normally happen when securities are delivered as Collateral in the financial markets. Typically, such securities are sold or otherwise transferred outright (for example, under a securities repurchase (repo) or stock lending transaction), in connection with which the seller represents to the buyer that the securities are sold "free and clear" of any third party interest.

Thus, the Secured Party loses its security interest when it exercises its Right of Use to sell the Collateral. The Secured Party will normally, however, either (1) have to account to the Security Collateral Provider for the proceeds of the securities or (2) re-deliver fungible equivalent securities. These obligations would normally be personal obligations of the Secured Party, sounding in debt, and therefore capable of being discharged by set-off.

Accordingly, if the Secured Party has not yet re-acquired fungible equivalent securities for delivery to the Security Collateral Provider at the time of a default by the Security Collateral Provider, the Secured Party would seek to set off the secured liabilities against the value at

80 See the answer to question 1 above and question 19 below for a discussion of the English position in relation to the recognition of New York law as the governing law of the New York Annex.

81 This is often referred to loosely as a "right of rehypothecation", however it is better practice, especially when discussing these issues with local counsel in relation to a cross-border collateral arrangement, to avoid that term, which strictly speaking refers only to re-pledging. A number of jurisdictions allow re-pledging of pledged Collateral under certain conditions, but prohibit or severely limit other types of use by the Secured Party, for example, re-sale.

that time of the Collateral. A well-drafted security document would normally include an appropriate contractual set-off provision for this purpose.

Similarly, if the Secured Party itself were to become insolvent, the Security Collateral Provider would be an unsecured creditor of the Secured Party in relation to the value of the securities sold by the Security Collateral Provider pursuant to the Right of Use. The Security Collateral Provider may, in such circumstances, seek to set off the value of the Collateral against its liabilities to the Security Collateral Provider under an appropriate contractual set-off provision.

Where the FCA Regulations apply, paragraphs (2) to (4) of regulation 16 in essence provide for such a result. In other words, the effect of the inclusion of a Right of Use in a Security Document if such Right of Use is exercised by the Secured Party is to convert the Security Document into a title transfer financial collateral arrangement, at least as far as the mechanism of the arrangement is concerned.[82]

One final theoretical point, although now only of relevance where the FCA Regulations do not apply: as mentioned above, it has been suggested that the inclusion of a Right of Use in a mortgage or charge should be considered a clog on the equity of redemption, which would render the Right of Use void.[83] Under this doctrine, which is a corollary of the long-established principle "once a mortgage, always a mortgage", a mortgagor's equity of redemption may not be extinguished by any covenant or agreement made at the time of the mortgage and as part of the mortgage transaction.[84]

Though we note academic arguments to the contrary, we believe it to be the better view that the clog doctrine would not apply to a security interest created over dematerialised or indirectly held securities in electronic form.[85] In such a case, the security interest is created over co-proprietary rights in a fungible pool of securities. The assets in such a pool are, by their nature, shifting, and it is not possible for the Security Collateral Provider to receive back the identical securities it originally transferred as Collateral. There is therefore no clog preventing the mortgagor in such circumstances getting back exactly what he mortgaged.

There is a related rule that a mortgagee may not stipulate for additional advantages in a mortgage beyond the mortgagor's covenant to repay the secured debt with interest. This is generally referred to as the rule against collateral advantages (using the term "collateral" in its original sense of "by the side of" (in this case, by the side of the main advantage) or perhaps "connected but subordinate"). The rule against collateral advantages was particularly potent when the charging of interest was prohibited by the usury laws. In such circumstances, collateral advantages were often viewed as disguised interest. There was, moreover, a more general judicial concern at the time the doctrine first developed that mortgagees would seek to oppress or otherwise take advantage of mortgagors at a time when they were in straitened circumstances.

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82 We make no comment here or anywhere else in this memorandum on the accounting or tax treatment of any collateral arrangements.

83 Some legal practitioners take the view that the inclusion of a clog on the equity of redemption would render the mortgage or charge itself void, however the better view is that the rule simply invalidates the contractual provision constituting the clog. Note also that although the clog doctrine arose originally in relation to legal mortgages, there is persuasive authority that the rule should apply to equitable mortgages, charges, and other security interests. *G&C Kreglinger v New Patagonia Meat and Cold Storage Co* [1914] AC 25, 31, HL.

84 *Vernon v Bethell* (1762) 2 Eden 110 at 113; 28 ER 838 at 839; *Samuel v Jarrah Timber and Wood Paving Corp* [1904] AC 323.

85 One of the counterarguments relates to the risk that the Security Collateral Provider is faced with a credit exposure to the Secured Party if the assets that have been reused constitute excess collateral. See for example the Australian case of *Lift Capital Partners Pty Ltd v Merrill Lynch International* (2009) 253 ALR 482 [140] – [151] where a right of use provision was struck down.

Since the abolition of the usury laws, the rule has been relaxed, and it is now established by a line of cases that a collateral advantage of a mortgagee will only be struck down if the advantage is unfair or unconscionable and not merely unreasonable.[86] We do not believe that a Right of Use would, absent special circumstances, be considered unfair or unconscionable if freely agreed at arm's-length between commercial counterparties.

11. *What is the effect, if any, under the laws of England on the validity, continuity, perfection or priority of a security interest in Eligible Collateral under each Security Document of the right of the Security Collateral Provider to substitute Collateral pursuant to Paragraph 4(d) of the New York Annex and the English Deed? How does the presence or absence of consent to substitution by the Secured Party affect your response to this question? Please comment specifically on whether the Security Collateral Provider and the Secured Party are able validly to agree in the Security Document that the Security Collateral Provider may substitute Collateral without specific consent of the Secured Party and whether and, if so, how this may affect the nature of the security interest or otherwise affect your conclusions regarding the validity or enforceability of the security interest.*

If the Security Collateral Provider has the right to require the Secured Party to substitute Collateral then, in our opinion, there is a risk that the security interest may be characterised as a floating rather than a fixed charge under English law. Before turning specifically to the question of the effect of substitution, it is important to consider the nature and characteristics of a floating charge.

(1) <u>Fixed versus floating charges</u>

Every charge created under English law is either fixed[87] or floating in nature in relation to the asset over which it is created. It is, of course, possible for the same charging document to include a fixed charge in relation to one or more assets and a floating charge in relation to one or more other assets. But each charge will be either fixed or floating (but not both) in relation to any particular asset.

A fixed charge is a charge in relation to specifically identified property that applies immediately to that property or, if the Security Collateral Provider does not yet own the property, immediately upon the Security Collateral Provider's acquisition of the property.

A floating charge is somewhat more difficult to define, and this difficulty has generated a reasonable amount of case law. It is a concept not found in many legal systems outside the English common law tradition, but it has proved to offer a number of significant practical advantages, notably because of its great commercial flexibility, as well as certain important disadvantages, discussed below.

It is clear that it is not sufficient, in order to establish a fixed rather than a floating charge, that the parties describe the charge as "fixed" in the charging document. The courts have, in a number of cases, considered the substantive characteristics of a purported fixed charge and have, as a result, recharacterised the charge as floating.[88]

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86 *Biggs v Hoddinot* [1898] 2 Ch 307; *Kreglinger v New Patagonia Meet and Cold Storage Co Ltd* [1914] AC 25; *Knightsbridge Estates Trust Ltd v Byrne* [1939] Ch 441; *Cityland and Property (Holdings) Ltd v Dabrah* [1968] Ch 166; *Multiservice Bookbinding Ltd v Marden* [1979] Ch 84.

87 The term "specific charge" is also sometimes used, instead of "fixed charge", particularly in older case law.

88 *Re Armagh Shoes Ltd*. [1982] NI 59

The key point is to determine the fundamental nature of the rights and the interest created in favour of the Secured Party. Romer LJ set out a classic description of a floating charge in the Court of Appeal decision in *Re Yorkshire Woolcombers Association Ltd*:[89]

> "[I]f a charge has the three characteristics that I am about to mention it is a floating charge. (1.) If it is a charge on a class of assets of a company present and future; (2.) if that class is one which, in the ordinary course of the business of the company, would be changing from time to time; and (3.) if you find that by the charge it is contemplated that, until some future step is taken by or on behalf of those interested in the charge, the company may carry on its business in the ordinary way as far as concerns the particular class of assets I am dealing with."

Re Yorkshire Woolcombers Association Ltd reached the House of Lords under the name *Illingworth v Houldsworth.*[90] In the House of Lords decision, Lord Macnaghten said:

> "A specific charge, I think, is one that without more fastens on ascertained and definite property or property capable of being ascertained and defined; a floating charge, on the other hand, is ambulatory and shifting in its nature, hovering over and so to speak floating with the property which it is intended to affect until some event occurs or some act is done which causes it to settle and fasten on the subject of the charge within its reach and grasp."

The fact that assets which are subject to a charge which is expressed to be a fixed charge are of a shifting or fluctuating character will not in itself render the charge a floating charge if the chargor is restricted from dealing with the assets, for example by means of a covenant not to dispose of or charge the assets in question and to pay the proceeds of such assets into a bank account which is blocked or subject to restrictions imposed and enforced by the chargee.[91]

The extent to which a chargor is able to deal in the assets has been subject to much judicial consideration, particularly in relation to receivables. It had in the past been suggested it was possible to separate a book debt from its proceeds and grant a fixed charge over book debt and a floating charge over the proceeds and this was considered by the Privy Council in *Agnew v The Commissioner of Inland Revenue (Re Brumark Investments Limited)*.[92] It was held that it is not possible to separate a book debt and its proceeds for this purpose. Therefore a charge that purports to create a fixed charge on a book debt but a floating charge on the proceeds must be construed as a floating charge.

Lord Millet in the *Brumark Investments* case described a two stage process for determining whether a charge was a fixed or a floating charge. The first stage involved construing the security document to understand the intention of the parties. However, the object at this stage is not to discover whether the parties intended to create a fixed or a floating charge. The object is to ascertain the nature of the rights and obligations which the parties intended to grant each other in respect of the

89 [1903] 2 Ch 284 (CA) at page 295.

90 [1904] AC 355 (HL) at page 358.

91 *Re Keenan Brothers Ltd* [1986] BCLC 242 and *Re Atlantic Medical Ltd*. [1992] BCC 653 which was confirmed by the Court of Appeal in *Re ASRS Establishment Limited, D.Q Henriques v Buchler* [2002] BCC 64.

92 [2001] UKPC 28 (Privy Council).

charged assets. The second stage of the process is one of categorisation. This is a matter of law and not of intention. If the intention of the parties, properly gathered from the language of the security document, is to grant the chargor rights in respect of the charged assets which are inconsistent with the nature of a fixed charge, then the charge cannot be a fixed charge however the parties may have chosen to describe it. The decision in *Brumark Investments* confirms that it is inconsistent with the existence of a fixed charge that the assets subject to it can be released from the security at the will of the chargor without the consent of the chargee; there must be real, and not merely illusory, control provisions in respect of the charged assets.

The House of Lords also considered charges over book debts in *Re Spectrum Plus Ltd*[93] and set out a specific test for determining whether a fixed or floating charge has been created. The House of Lords held that, where a security instrument prohibits a chargor from disposing of its book debts before they are collected and requires that the book debt proceeds be paid into an account with the chargee bank, the critical question in determining whether a fixed or floating charge has been created is whether the chargor is free to draw on the account pending notice otherwise from the chargee bank. The House of Lords held that a chargor having that right would be inconsistent with the charge being a fixed charge and that any label given to the charge by the parties would be irrelevant.

The question of whether the security interests created under the Security Documents will be characterised as fixed charges rather than floating charges will therefore depend, among other things, on whether the Secured Party under the Security Documents, has the requisite degree of control over the Security Collateral Provider's ability to deal in the relevant assets and, if so, whether such control is exercised by the Secured Party in practice.

In relation to the characterisation of the Security Documents (other than in respect of the substitution of collateral issues which we address below) we note the following:

(i) We believe that it is the better view that cash deposits by way of security do not usually constitute book debts. However, there is uncertainty on the point and the cash deposits may be more likely to be treated as a book debt where the Security Collateral Provider is a financial institution. It has been suggested that debt securities may also potentially be book debts if the Security Collateral Provider is a financial institution.

(ii) The Security Documents do not distinguish between book debts and their proceeds of collection.

(iii) The types of collateral arrangements set out in the Security Documents typically do not allow the Security Collateral Provider freely to receive or withdraw the proceeds of a cash deposit (or debt security right) prior to default. Such proceeds are received by the Secured Party and continue to be held subject to the relevant security interest. They eventually pass back to a non-defaulting Security Collateral Provider on the same terms as any other Collateral is released in accordance with the mark-to-market mechanics of the Security Document.

93 [2005] UKHL 41

Note that distributions of income and other rights received on securities held as Collateral do not in our view constitute proceeds. It has been suggested that there are three main factors to consider with respect to income:

(i) how directly the assets generate the income;

(ii) how close the generation of income comes to being the sole value of the asset; and

(iii) whether the asset is destroyed by the generation of the income.[94]

The income and rights received on securities do not destroy the securities (the right to receive the principal amount is independent of the right to income). Therefore, only the monies received from the debtor of the relevant book debt in whole or partial payment of the principal of the debt should constitute proceeds. Note also that payments of interest amounts on cash Collateral do not in our view constitute proceeds for the same reasons.

It is our view that neither Security Document should be construed as a floating charge, provided that, in the case of the New York Annex, the parties specify in Paragraph 13(e)(ii) that the Security Collateral Provider must obtain the consent of the Secured Party to any substitution pursuant to Paragraph 4(d) of the New York Annex (in respect of which see below).

(2) Disadvantages of floating charges

Floating charges have a number of disadvantages relative to fixed charges. These disadvantages include the following:

(A) Certain statutorily preferred claims (the main types are claims by employees and contributions to pension schemes) take priority over a creditor with a floating charge in a liquidation or an administration whereas a fixed charge ranks ahead of such claims.

(B) In respect of a floating charge created on or after 15 September 2003 a receiver, liquidator or administrator must set aside a prescribed part of the floating charge realisations for the benefit of the unsecured creditors.[95] The maximum amount of the ring-fenced fund is £600,000.[96]

(C) In an administration the remuneration and expenses of the administrator are payable out of assets subject to the floating charge.[97] Liquidation expenses are now also payable out of assets subject to a floating charge.[98]

(D) In an administration, the administrator may deal with the property covered by the floating charge without the leave of the court and without any need, for example, to make up to the chargee any shortfall in market value on a sale.

94 H Beale and others, The law of Security and Title-Based Financing (2nd edition, OUP 2012), para 6.130

95 Unless the realised value of the assets subject to floating charges is less than £10,000 and the relevant officeholder considers that the cost of distributing the prescribed part would be disproportionate to the benefit to unsecured creditors of doing so. See section 176A(3) Insolvency Act 1986.

96 Section 176A Insolvency Act 1986; Insolvency Act 1986 (Prescribed Part) Order 2003, SI 2003/2097.

97 Insolvency Act 1986, Sch B1, para 99(3) and (4).

98 Section 176ZA Insolvency Act 1986.

(E) A floating charge is subject to wider powers of avoidance under the Insolvency Act 1986 than a fixed charge would be by virtue of section 245 of the Insolvency Act 1986.

(F) A floating charge has weak priority against purchasers and chargees of the assets concerned and against lien holders, execution creditors, and creditors with rights of set-off.

(G) In relation to floating charges created on or after 15 September 2003, the holder of a floating charge is no longer be entitled to appoint an administrative receiver of the Security Collateral Provider and thereby prevent the appointment of an administrator (unless one of a limited number of exceptions applies).[99] The ability of a Secured Party to appoint a receiver is discussed in the answer to question 12 below.

However, if a floating charge is constituted under a financial collateral arrangement under the FCA Regulations the disadvantages listed at (A) to (E) above will not apply.[100] In our view given the nature of the arrangements contemplated by the Security Documents we consider it unlikely that the disadvantage set forth at (F) would be a material concern.

(3) Characterisation of mark-to-market collateral arrangements

The type of collateral arrangement set out in each of the Security Documents may, in commercial terms, be characterised as a mark-to-market collateral arrangement. That means that periodically the current net exposure of one party to the other party under the ISDA Master Agreement is determined and compared, in an agreed base currency, to the value of Eligible Collateral then held by that party (if any). After various adjustments (for unsecured thresholds, minimum transfer amounts, valuation "haircuts", and so on), the Security Collateral Provider may be required to provide additional Eligible Collateral, if there is excess exposure, or be entitled to return of Eligible Collateral, if there is excess Collateral. The amount of Eligible Collateral held by the Secured Party normally therefore fluctuates.

The question often arises whether a security interest over Collateral subject to a mark-to-market arrangement should be considered, for that reason alone, to be a floating charge. The short answer is no. The mere fact that the amount of Collateral subject to a security interest fluctuates does not make the security interest a floating charge.[101]

The real question is the degree of control exercised by the chargor. If the Collateral is held by the Secured Party or its agent and the Security Collateral Provider has no right of substitution, for example, then normally the security interest would be considered fixed in relation to the Collateral held at any one time by the Secured Party.

(4) Substitution of Collateral

99 Section 250 Enterprise Act 2002.

100 FCA Regulations, regs 8 and 10.

101 *Queens Moat Houses plc, Norfolk Capital Hotels Ltd v Capita IRG Trustees Ltd* [2004] EWHC 868. See also Gullifer L, *Goode on Legal Problems of Credit and Security* (5th Edition, Sweet and Maxwell 2013) paras 4-11 to 4-12.

Turning, then, to the specific question of substitution of Collateral, if the Security Collateral Provider has an unrestricted right of substitution of Collateral (so that, in exchange for an equivalent amount of substitution, it is entitled to release of specific Collateral of its own choosing), then there is a risk that the relevant Security Document constitutes a floating charge. This is because the Security Collateral Provider could be considered to direct the use of the assets held by the Secured Party prior, of course, to the occurrence of a default.

In this regard, Vaughan Williams LJ in *Re Yorkshire Woolcombers* said 'if at the will of the mortgagor he can dispose of it and prevent its being any longer a security, although something else may be substituted more or less for it, that is not a specific security'.[102]

Such a right of substitution could exist in any collateral arrangement, whether or not it has been established on a mark-to-market basis. As a matter of practice, however, such a right of substitution is common in mark-to-market collateral arrangements.

If the Secured Party has an unrestricted veto on any substitution or, in other words, an unrestricted right to refuse its consent, then the security interest should not be considered a floating charge.[103]

An important caveat, however, is that this consent requirement should be a real one and not, in practice, ignored.

In other words, it is not necessarily enough for the relevant Security Document to specify that the Secured Party has an unrestricted veto or right to refuse consent. The parties must behave consistently with that requirement and should not have an unwritten, informal, or *de facto* understanding that substitutions will be permitted as a matter of course. Otherwise, the consent requirement might be challenged by a liquidator or administrator as a sham, and the security interest might then be recharacterised as a floating charge by the court. This risk will, of course, turn on the specific facts and circumstances of each case, and the quality of the evidence produced by each side to any dispute on this question.

A final point to consider is the situation where the parties have agreed that any substitution requires the Secured Party's consent, but that the Secured Party may not refuse its consent in certain circumstances, for example, if certain conditions are fulfilled. While not all such clauses would necessarily result in the relevant Security Document being characterised as a floating charge, it is difficult to say definitively how much the Secured Party's right of veto or right to refuse consent may be restricted before a material risk of recharacterisation arises.[104]

The English Deed contains in Paragraph 4(d)(ii) a requirement for the Secured Party to consent to any substitution. In our opinion, this should result in the Secured Party retaining a sufficient degree of control for the charge created by the English Deed to be characterised as a fixed charge. The New York Annex does not contain a

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102 [1903] 2 Ch 284 (CA) at page 294

103 See for example the discussion in H Beale and others, *The law of Security and Title-Based Financing* (2nd edition, OUP 2012), para 6.127 which concludes that where the chargee's consent is needed for every substitution there is clearly sufficient restrictions on the chargor to qualify as a fixed charge.

104 See also the discussion on consents to disposals in Gullifer L, *Goode on Legal Problems of Credit and Security*, (Fifth edition, Sweet & Maxwell 2013), para 4-28 which discusses whether a requirement to act reasonably when considering whether to grant a consent to a disposal of assets would affect the analysis.

requirement for such consent on the part of the Secured Party unless an appropriate election is made by the parties in Paragraph 13(e)(ii). In our opinion, if this election is not made, there is a strong presumption that a security interest created on the form of the New York Annex would be characterised by an English court as a floating charge.

Accordingly, we would recommend that parties using the New York Annex make the election requiring consent to substitution where at least one of the parties is an English Company.

Regarding (3) and (4) above, we are not aware of any case that specifically considers the characterisation of a charge as fixed or floating in the context of a mark-to-market collateral arrangement. We believe, however, that the current state of the law supports the analysis above.

As noted above, even if the relevant charge is a security financial collateral arrangement some of the disadvantages of a floating charge will continue to apply (hence our recommendation that the parties agree that any substitution of Collateral should be subject to the consent of the Secured Party).

Enforcement of rights under the Security Documents by the Secured Party in the absence of an insolvency proceeding

Note the additional assumption in (j) above which applies to questions 12 to 15 below.

12. *Assuming that the Secured Party has obtained a valid and perfected security interest in the Eligible Collateral under the laws of your jurisdiction, to the extent such laws apply, by complying with the requirements contained in the responses to questions 1 to 6 above as applicable, what are the formalities (including the necessity to obtain a court order or conduct an auction), notification requirements (to the Security Collateral Provider or any other person) or other procedures, if any, that the Secured Party must observe or undertake in exercising its rights as a Secured Party under each Security Document, such as the right to liquidate Collateral? For example, is it free to sell the Collateral (including to itself) and apply the proceeds to satisfy the Security Collateral Provider's outstanding obligations under the ISDA Master Agreement? Do such formalities or procedures differ depending on the type of Collateral involved?*

The issues raised by the question principally concern the proprietary effect of the Security Documents. As discussed in our answer to question 2 above, the law applicable to those aspects will vary depending on the nature of the Collateral. The law applicable to the contractual aspects of the Security Documents, discussed in our answer to question 1, will be relevant to the threshold issue of determining the rights and remedies the parties purport to grant themselves but the availability of those rights and remedies will be subject to the proprietary law of the Collateral.

As we are discussing the position under English law in this memorandum, we assume for the purposes of this question that the Collateral is governed by English law as determined by the applicable conflict of laws rules relevant to that category of Collateral. As New York law will govern the contractual aspects of the New York Annex (subject to our answer to question 19 below), we focus below on the contractual position under the English Deed, but the discussion below will also be relevant to the New York Annex where the Collateral is governed by English law as determined by the applicable conflict of laws rules relevant to that category of Collateral, but as applied to the contractual remedies the parties have specified under the New York Annex.[105]

There are four principal remedies for a mortgagee under English law. These are sale of the secured property, the appointment of a receiver, taking possession, and foreclosure. Of these, a mere chargee (that is, a holder of a charge that does not also constitute a mortgage) has only the remedies of sale of the secured property and appointment of a receiver.

Of these, in a financial markets context, the power of sale is the remedy typically exercised by a mortgagee or chargee in relation to Collateral in the form of securities. The appointment of a receiver is generally not thought to confer any practical advantage in this context, and the mortgagee or chargee typically already has possession of the relevant securities (as would normally be the case under the English Deed).

Foreclosure is the process under which the mortgagor's equitable right to redeem the mortgaged property is declared by the court to be extinguished or destroyed and the mortgagee is left as owner of the property both at law and in equity (subject only to prior encumbrances). The mortgagee is then free to sell the property or to retain title to it.

105 An English court, if required to consider a right or remedy granted by the New York Annex, would consider whether the right or remedy is of a type known to English law and would then apply English law relevant to that type of right or remedy to determine whether it is enforceable under English law and, if so, the manner of enforcement.

Foreclosure is always an act of court, and a mortgagee cannot foreclose and keep the assets for itself without a court order.[106] For this reason, it considered too time-consuming and cumbersome to be a practical remedy in the context of a financial market security arrangement of the type exemplified by the Security Documents. In addition, in certain circumstances, the court may re-open the foreclosure order, restoring the mortgagor's equitable right to redeem. For these reasons, foreclosure is rarely, if ever, used by a mortgagee of securities.

The exercise by the Secured Party of its right to "liquidate" Collateral by selling it under the English Deed is permitted by English law. It is not necessary for any particular formalities to be followed by the Secured Party in exercising its right of sale. Accordingly, the Secured Party may on enforcement of the English Deed sell the Collateral.

In particular, a court order or auction is not required and notice of sale need not be given to the Security Collateral Provider, although in practice secured creditors do often give a short period of notice before selling Collateral. This does not differ depending on the type of Collateral involved.

In exercising its power of sale, the Secured Party is subject to a duty to take reasonable care to obtain the best price reasonably available at the time.[107] This will normally be the current market value of Collateral comprising securities.[108]

Where the FCA Regulations do not apply, a Secured Party may not sell Posted Collateral to itself, either alone or with others, unless the sale is made by the court and the Secured Party has obtained leave to bid. This is because such a transaction would amount to foreclosure without the leave of the court. In addition, there is a broader policy basis for the rule, which is that a person should not put himself in a position where his duty (in this case, to obtain the best price reasonably available) and his interest (in this case, to pay as low a price as possible) conflict.[109]

It is established that a mortgagee may sell mortgaged property to a company in which the mortgagee has an interest, provided that it can prove that the sale was in good faith and that it had taken reasonable steps to obtain the best price reasonably obtainable at that time.[110] *A fortiori*, a mortgagee may sell mortgaged property to an affiliated company, subject to the same proviso.

The policy underlying the traditional prohibition on a mortgagee appropriating mortgaged property without a foreclosure order has been overridden by the FCA Regulations, where they do apply. Regulations 17 and 18 of the FCA Regulations provide that a collateral-taker under a security financial collateral arrangement may appropriate financial collateral taken under a security financial collateral arrangement without a court order for foreclosure. This is subject to a duty of the collateral-taker to value the relevant financial collateral "in accordance with

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106 *Re Farnol Eades Irvine & Co.* [1915] 1 Ch 22.

107 *Cuckmere Brick Co Ltd v Mutual Finance Ltd* [1971] Ch 949; 2 All ER 633. See also discussion of this issue in (i) *Fisher and Lightwood's Law of Mortgage* (14th edition 2014), paragraph 30.23 and the cases cited there and (ii) H Beale and others, *The law of Security and Title-Based Financing* (2nd edition, OUP 2012), para 18.49.

108 *Downsview Nominees Ltd v First City Corporation Ltd* [1993] AC 295, Privy Council (appeal from the New Zealand Court of Appeal); *Freeguard v Royal Bank of Scotland plc*, The Times, 25 April 2002.

109 Some of the case law appears to be based on the argument that a mortgagee cannot sell to itself, for the reason that "[a] sale by a person to himself is no sale at all". *Obiter dictum* of Lindley LJ in *Farrars v Farrars Ltd* (1888) 40 ChD 395 at 409. This is, strictly speaking, a nonsensical argument as the mortgagee would simply be selling the equity of redemption to itself as agent for, and therefore on behalf of, the mortgagor. The true basis of the rule, as noted in the text above, is that a sale by a mortgagee to itself pursuant to its power of sale under the mortgage is, in effect, a foreclosure without authority of the court. It also offends the broader policy against self-dealing by a fiduciary.

110 *Farrars v Farrars Ltd* (1888) 40 ChD 395; *Tse Kwong Lam v Wong Chit Sen* [1983] 3 All ER 54.

the terms of the arrangement and in any event in a commercially reasonable manner". Also, in contrast to the position in relation to foreclosure, the collateral-taker does not after appropriation lose its right to claim for any deficit in relation to its claim remaining after enforcement or its obligation to account to the collateral-provider for any excess it realises over its claim after enforcement. Note that it is possible for the collateral-provider to obtain relief in respect of appropriation but it is expected that any such relief would be rare.[111] In order to be able to rely on the remedy of appropriation, the English Deed would need to be amended to include the right to appropriate coupled with an appropriate valuation mechanism that was commercially reasonable.

Finally, in our opinion there would be a right of set-off available under Paragraph 8(a)(ii)(B) of the English Deed. In certain circumstances rights of set-off can be subject to intervening claims and the issue of set-off against a deposit that has been attached or to which an intervener has made a claim is complex, but set-off will generally be available, provided that the Secured Party and the Security Collateral Provider have agreed that the claims arising between them shall be set off, and both claims were incurred prior to the Secured Party having notice of the attachment or intervention. A judicial enforcement order which operates as a restraining injunction may prohibit the exercise of a right of set-off, unless this right is excluded from the effect of the order, as is common only in the case of freezing injunctions.[112]

13. *Assuming that (a) pursuant to the laws of your jurisdiction, the laws of another jurisdiction govern the creation and/or perfection of a security interest in the Eligible Collateral transferred by way of security pursuant to each Security Document (for example, because such Collateral is located or deemed located outside your jurisdiction), and (b) the Secured Party has obtained a valid and perfected security interest in the Eligible Collateral under the laws of such other jurisdiction, are there any formalities, notification requirements or other procedures that the Secured Party must observe or undertake in your jurisdiction in exercising its rights as a Secured Party under each Security Document?*

No.

14. *Are there any laws or regulations in your jurisdiction that would limit or distinguish a creditor's enforcement rights with respect to Collateral depending on (a) the type of transaction underlying the creditor's exposure, (b) the type of Collateral or (c) the nature of the creditor or the debtor? For example, are there any types of "statutory liens" that would be deemed to take precedence over a creditor's security interest in the Collateral?*

In relation to a Collateral Taker dealing with an English Company as Collateral Provider, there are no rules or regulations of the kind mentioned in clauses (a), (b) or (c) of this question. The types of Eligible Collateral involved should not have any effect on enforcement rights. There are no "statutory liens" or preferred claims in relation to a fixed charge over Eligible Collateral of the kind under review, although as discussed in the answer to question 11 above certain claims take precedence over a floating charge.

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111 For example, see *Cukurova Finance International Ltd v Alfa Telecom Turkey Ltd.* [2013] UKPC 2 and *Cukurova Finance International Limited, Cukurova Holdings A.S. v Alfa Telecom Turkey Limited* [2013] UKPC 20. Relief was granted where, *inter alia*, the collateral-provider had tendered what would have been a valid prepayment within one month of the appropriation but the prepayment was refused, the purpose of the appropriation of the shares had primarily been to obtain control of the issuer of the shares and the valuation of the shares did not take into account the value of the control over the issuer the shares would grant.

112 Under rule 25.1(1)(f) of the Civil Procedure Rules, where a plaintiff can show a good arguable claim to be entitled to money from a defendant, and there is a real risk that the defendant will remove assets from the jurisdiction, or dispose of them so as to render them untraceable, an English court may grant an injunction, known as a "freezing injunction", to restrain the defendant from disposing of the assets or removing them from the jurisdiction. Such injunctions were previously known as "Mareva injunctions" after the case *Mareva Compania Naviera SA v International Bulk Carriers SA* [1975] 2 Lloyd's Rep 509.

15. *How would your response to questions 12 to 14 change, if at all, assuming that an Event of Default, Relevant Event or Specified Condition, as the case may be, exists with respect to the Secured Party rather than or in addition to the Security Collateral Provider (for example, would this affect the ability of the Secured Party to exercise its enforcement rights with respect to the Collateral)?*

If an Event of Default, Relevant Event or Specified Condition is subsisting in relation to the Secured Party rather than the Security Collateral Provider, the Secured Party will be able to exercise its enforcement rights if there is also an Event of Default, Relevant Event or Specified Condition subsisting in relation to the Security Collateral Provider or an Early Termination Date has been designated (or deemed to occur) as the result of an Event of Default or Specified Condition in relation to the Security Collateral Provider.

In any other case, the Secured Party may not enforce its security. Note that in these circumstances Paragraph 8(b) of the New York Annex applies to protect the Security Collateral Provider. An equivalent provision was not considered necessary in the English Deed.

Enforcement of rights under the Security Documents by the Secured Party after commencement of an English insolvency proceeding in respect of an English Company

Note the additional assumption in (k) above which applies to questions 16 to 18 below. In respect of the commencement of insolvency proceedings in England in respect of an English Branch that is providing Collateral please see Annex 1.

16. *How are competing priorities between creditors determined in your jurisdiction? What conditions must be satisfied if the Secured Party's security interest is to have priority over all other claims (secured or unsecured) of an interest in the Eligible Collateral?*

The English law rules relating to priorities between creditors are complex, but the basic principles are as follows:

(a) Secured claims take precedence over unsecured claims.

(b) Subject to (c) below, secured claims take priority in the order in which the security interest was created.

(c) Where there is a competition between a legal interest (including a legal security interest) and an equitable interest (including an equitable security interest), the legal interest will take precedence over the equitable interest irrespective of the time of creation, provided the legal interest was taken without knowledge of the equitable interest.

In relation to (c), a legal security interest is one where the Secured Party has a security interest coupled with legal title to the Collateral (for example, it is registered as the owner of Collateral in the form of registered securities) while an equitable security interest is one where the Secured Party has a security interest without legal title (which, instead, continues to be held by the Security Collateral Provider or is held by a third party, for example, a nominee).

For the Secured Party's security interest to have priority over all other claims (secured or unsecured), the Secured Party will need to have obtained a security interest in the relevant Collateral prior to any other security interest being created (or without knowledge of other equitable interests if the Secured Party obtains a legal security interest).

To protect against the possibility of the Secured Party's security interest being defeated by a subsequent legal interest taken without knowledge of the Secured Party's interest, the Secured Party should wherever possible obtain a legal security interest, by taking legal title. Note that in respect of intermediated securities, it may not be possible for the Secured Party to take legal title because the interest of the Security Collateral Provider is itself only an equitable interest.

In the case of securities and other investments, this will involve the Secured Party or its nominee becoming registered as the holder of the securities in the books of the issuer or the relevant clearing system, as applicable. If the Secured Party is not so registered, then it will have an equitable security interest that could lose priority to a subsequent security interest taken by a third party, where that third party, without notice of the Secured Party's prior interest, became the registered holder of the Collateral and thereby acquired a legal security interest.

The rule in *Dearle v Hall*[113] governs the priority of competing assignments of a debt. Under that rule, priority goes to the first assignee to give notice to the relevant debtor of its assignment, provided that such assignee only has priority over an earlier assignee if it does not have notice of the earlier assignment. However, the rule in *Dearle v Hall* will not apply to Collateral delivered directly to the Secured Party or to a Custodian for the account of the Secured Party (as opposed to for the account of the Security Collateral Provider).

Please see question 11 above, as to the differences between the position in respect of a fixed charge and a floating charge.

17. *Would the Secured Party's rights under each Security Document, such as the right to liquidate the Collateral, be subject to any stay or freeze or otherwise be affected by commencement of the insolvency (that is, how does the institution of an insolvency proceeding change your responses to questions 12 and 13 above, if at all)?*

Where an English Company is or is likely to become unable to pay its debts within the meaning of the Insolvency Act 1986, the court may make an administration order or one of the out-of-court routes into administration may be used by the holder of a qualifying floating charge or the shareholders or directors of a company. An administrator may be appointed by a qualifying floating charge holder on the basis that its security is enforceable, even if a party is not, or is not likely to become, unable to pay its debts.

The statutory purposes of administration are set out in a three-part test in paragraph 3(1)(c) of Schedule B1 to the Insolvency Act 1986. The primary objective of administration is to rescue the company as a going concern. The secondary objective is to achieve a better result for a party's creditors as a whole than would be likely if the company were wound up without going into administration if the primary objective is not reasonably practicable or the secondary objective would achieve a better result for the creditors as a whole. The third objective, which only applies if neither of the other two objectives is possible, is to realise property in order to make a distribution to one or more of the secured or preferential creditors but without "unnecessarily harming" the interests of the unsecured creditors. The emphasis of the statutory purpose of administration is the rescue of the company in all cases – the enforcement of security is subordinate to this primary objective.

When an administrator is appointed, or in some cases at an earlier stage in the procedure, no resolution may be passed or order made for the winding up of the company, no steps may be taken to enforce any security over the company's property, and no other proceedings and no execution or other legal process may be commenced or continued except with the leave of the court or the administrator's consent.

This would not prevent, however, the designation (or deemed occurrence) of an Early Termination Date under Section 6(a) of the ISDA Master Agreement or the operation of the close-out netting provisions of Section 6(e), even if the relevant Event of Default occurred after the date on which the administrator is appointed or the earlier date of this moratorium. This would also not prevent the exercise of contractual rights of set-off (as described in more detail in the answer to question 26 below). This is because the close-out netting provisions are not a "proceeding", "execution" or "legal process" in the sense intended in paragraphs 43 and 44 of Schedule B1, but rather a contractual self-help remedy not involving court or arbitral process.[114]

113 (1828) 3 Russ 1; 38 ER 475 LC; [1824-34] All ER Rep 28. The rule in *Dearle v Hall* was enacted in statutory form in section 137(1) of the Law of Property Act 1925.

114 See *Re Paramount Airways Ltd* [1990] BCC 130; *Re Olympia & York Canary Wharf Ltd* [1993] B.C.C. 154.

Moreover, regulation 8 of the FCA Regulations disapplies the administration stay on enforcement of security in relation to any security financial collateral arrangement. Accordingly, a Security Document will not be subject to the administration stay if it is a security financial collateral arrangement as discussed in part II above.

Prior to the enactment of the Enterprise Act 2002 a secured creditor holding security over substantially all of the assets of the company, where such security included a floating charge, could block the appointment of an administrator. This would not have applied in the case of the Security Documents (assuming that the Eligible Collateral provided by the Security Collateral Provider does not comprise substantially all its assets). In any event, the Enterprise Act 2002 has severely restricted the circumstances in which a secured creditor could appoint an administrative receiver in order to prevent the appointment of an administrator. The statutory moratorium does not apply to administrative receivership.

A company voluntary arrangement (**CVA**) binds all unsecured creditors but cannot affect the right of a secured creditor to enforce its security except with such creditor's consent. However, under Section 1A and Schedule A1 of the Insolvency Act 1986 the directors of an "eligible company" may obtain a moratorium on creditor action, including the enforcement of claims against the company, in order to put together a proposal for a voluntary arrangement. The moratorium is for an initial period of up to 28 days with the option for the creditors to extend the moratorium for up to a further two months. An eligible company is a "small company", that is, a company that satisfies two out of three of various statutory size limitations set out in section 382(3) of the Companies Act 2006, subject to various exclusions from eligibility. The exclusions are designed to protect the financial markets, including deposit taking institutions, parties to various types of financial market contracts (essentially, contracts related to organised exchanges and clearing houses), and participants in payment and securities settlement systems.

Regulation 8 of the FCA Regulations also disapplies the moratorium described above in relation to any security financial collateral arrangement. Accordingly, a Security Document will not be subject to the moratorium if it is a security financial collateral arrangement as discussed in part II above.

Where the location of the Collateral is outside England but within the territory of a Member State of the EU, the EC Insolvency Regulation may be relevant to this question. The effect of the EC Insolvency Regulation is discussed below at question 20.

18. *Will the Security Collateral Provider (or its administrator, provisional liquidator, conservator, receiver, trustee, custodian or other similar official) be able to recover any transfers of Collateral made to the Secured Party during a certain "suspect period" preceding the date of the insolvency as a result of such a transfer constituting a "preference" (however called and whether or not fraudulent) in favour of the Secured Party or on any other basis? If so, how long before the insolvency does this suspect period begins? If such a period exists, would the substitution of Collateral by a Counterparty during this period invalidate an otherwise valid security interest if the substitute Collateral is of no greater value than the assets it is replacing? Would the posting of additional Collateral pursuant to the mark-to-market provisions of the Security Documents during the suspect period be subject to avoidance, either because the Collateral was considered to relate to an antecedent or pre-existing obligation or for some other reason?*

Under the Insolvency Act 1986, a transaction may, by order of the court, be set aside or modified in the case of a winding-up or administration of a company:

(a) under section 238 (and related provisions), if (1) it constitutes a transaction at an undervalue with a person (that is, a gift to that person or a transaction under which the consideration received by the company is worth significantly less than the consideration given by the company to the other person), (2) the company is insolvent under the relevant test for insolvency in the Insolvency Act 1986 at the time of the transaction or is rendered insolvent by the transaction (this will be presumed to be the case unless the contrary is shown in relation to a transaction at an undervalue with a connected person), and (3) the transaction was entered into (i) within a prescribed period from the onset of insolvency (two years, regardless of whether or not the transaction is with a connected person), (ii) between the making of an administration application and the making of an administration order on that application, or (iii) the filing with the court of a copy of the notice of intention to appoint an administrator under paragraph 14 or 22 of Schedule B1 and the making of an appointment under that paragraph;

(b) under section 239 (and related provisions), if (1) it constitutes a preference given to a person (which will only be the case if the company, in deciding to enter into the transaction, is influenced by a desire to put that person in a better position in the event of the company's going into insolvent liquidation than it would otherwise have been in), (2) the company is insolvent under the relevant test for insolvency in the Insolvency Act 1986 at the time of the transaction or is rendered insolvent by the transaction, and (3) the transaction was entered into in the same periods as apply to section 238 (except that the prescribed period in (i) is two years in the case of a preference given to a connected person and six months in any other case); or

(c) under section 423 (and related provisions), if it constitutes a transaction at an undervalue entered into intentionally to prejudice creditors other than the person benefiting from the transaction (note that, in the case of these provisions, there is no prescribed period and no requirement that the company be, or be made by the transaction, insolvent at the relevant time). Note that an administrative receiver could potentially bring an action under section 423 of the Insolvency Act 1986 as agent for the English Company (as the victim).[115]

These rules may affect:

(i) improvements in the value of Collateral for existing Transactions pursuant to a substitution (as a result of the substituted Collateral being more valuable than the Collateral it replaces); and

(ii) the provision of additional Collateral to maintain the required Credit Support Amount in respect of Transactions that were in existence before the provision of the additional Collateral (that is, in commercial parlance, "top-up Collateral").

In relation to (i), Paragraph 4(d) of each Security Document contemplates that the Pledgor will provide Substitute Credit Support of a value equivalent to the original Posted Credit Support being replaced. It is, of course, possible that the Security Collateral Provider could provide Substitute Credit Support of a value greater than the original Posted Credit Support. If it can be established that in so doing the Security Collateral Provider was influenced by a desire to improve the position of the Secured Party in the event of the Security Collateral Provider's insolvent liquidation, then this could constitute a preference if the other conditions referred to in (b) above are also present.

115 See section 424(c) and Schedule 1, para 5 of the Insolvency Act 1986.

In relation to (ii), the provision of additional Eligible Collateral would be required by Paragraph 3(a) of each Security Document, and the Security Collateral Provider must comply in order to avoid a default. It is therefore unlikely that a court would find this arrangement preferential, even if the other conditions referred to in (b) above are present. For support for this view, see *Re MC Bacon Ltd*.[116] Of course, it is conceivable that this fact pattern could give rise to a preference if the intention of the Security Collateral Provider was in fact to prefer one creditor over another (for example, if there were two Security Documents each of which required the provision of top-up Collateral).

In the case of a transaction at an undervalue under (a) or (c) above, the Court of Appeal held in the case of *Hill v Spread Trustee Company*[117] that the giving of security for an existing debt may be a transaction at an undervalue that can be set aside on the borrower's insolvency. This is notwithstanding that the grant of security does not actually deplete the assets of an insolvent chargor. Nevertheless, it is our view on the basis of our assumptions that the grant of security under the Security Documents would be unlikely to constitute a transaction at an undervalue (although in relation to (i), if the Security Collateral Provider provides Substitute Credit Support of a value greater than the original Posted Credit Support then this would potentially be problematic).

Section 244 of the Insolvency Act 1986 makes provision for the avoidance of certain transactions entered into by a company that are or were extortionate, within a period of three years prior to a company entering administration or the company's going into liquidation. We believe that this rule is highly unlikely to apply to the Security Documents on the assumptions we have been asked to make.

Finally, under section 245 of the Insolvency Act 1986, a separate avoidance provision applies to floating charges. In the answer to question 11 above, we considered whether either Security Document could constitute a floating charge. If a Security Document were to be construed as a floating charge by an English court, section 245 provides that a floating charge is invalid if:

(i) the chargor is insolvent at the time of creation of the charge or becomes insolvent as a result of that transaction, although insolvency at the time of the creation of the charge is not a requirement for charges to connected persons; and

(ii) the charge is created:

  (w) in the case of a charge which is created in favour of a person who is connected with the company, in the period of 2 years ending with the onset of insolvency; or

  (x) in the case of a charge which is created in favour of any other person, in the period of 12 months ending with the onset of insolvency; or

  (y) in either case, at a time between the making of an administration application in respect of the company and the making of an administration order on that application, or

116 [1990] BCC 78.

117 [2006] EWCA Civ 542. While the decision in the *Spread Trustee* case considers transactions at an undervalue in the context of section 423, it is also relevant in the context of section 238.

(z) in either case, at a time between the filing with the court of a copy of notice of intention to appoint an administrator under paragraph 14 or 22 of Schedule B1 and the making of an appointment under that paragraph,

except that the charge is valid for money paid, the value of goods and services supplied or the discharge or reduction of the debt at or after the creation, and in consideration, of the floating charge, plus contractual interest.

The general effect of section 245 is that a floating charge for "new money" (that is, a new extension of credit at the time the floating charge is entered into) is not invalidated to the extent of the "new money" (or extension of credit) provided, but may be invalidated if granted for pre-existing debt if the tests in (i) and (ii) above are satisfied.

The effect of this in relation to the ISDA Master Agreement and a Security Document is that if a Security Document were characterised as a floating charge, the security interest under the Security Document might be invalidated on the above-mentioned principles in respect of Transactions in existence at the time the Security Document was executed but would probably survive in respect of Transactions entered into at or after the time the Security Document was executed.

As briefly noted in our response to question 11, regulation 10(5) of the FCA Regulations disapplies section 245 in respect of any security financial collateral arrangement. Accordingly, a Security Document that is a floating charge (e.g. because the right of substitution is not subject to the consent of the Secured Party) will not be subject to section 245 if it is a security financial collateral arrangement as discussed in part II above.

Additional issues

19. *Would the parties' agreement on governing law of each Security Document and submission to jurisdiction be upheld in your jurisdiction, and what would be the consequences if they were not?*

Parties agreement on governing law

As a general rule, English law respects commercial parties' choice of law in respect of their contractual obligations whether the law chosen is English or foreign. Slightly different rules apply, however, depending on whether English or New York law is chosen as the governing law and when the ISDA Master Agreement and Security Document was entered into.

The law applicable to a contract entered into after 1 April 1991 but prior to 17 December 2009 where there is a choice between the laws of different countries is determined by the Contracts (Applicable Law) Act 1990 which substantially incorporates the Rome Convention into English law.[118] The law applicable to a contract entered into on or after 17 December 2009 where there is a choice between the laws of different countries is determined by Regulation 593/2008 of 17 June 2008 on the law applicable to contractual obligations (**Rome I**). We discuss below the position under Rome I.

Rome I gives commercial parties the freedom to choose the law that applies to the contract - Rome I provides that the choice must be "made expressly or clearly demonstrated".[119]

118 Convention on the law applicable to contractual obligations opened for signature in Rome on 19 June 1980. Some contractual obligations are outside the scope of (i) the Rome Convention (and therefore outside the scope of the Contracts (Applicable Law) Act 1990) and (ii) Rome I.

119 Article 3(1) of Rome I

A choice of (i) New York law as the governing law of and ISDA Master Agreement (and therefore the New York Annex which forms part of the ISDA Master Agreement) or (ii) English law as the governing law of the English Deed would normally be upheld by the English courts. However, where all the other elements relevant to the situation at the time of the choice are connected with one country only, the fact that the parties have chosen New York law or English law will not prejudice the application of any rules of law under the laws of that other country which cannot be derogated from by contract.[120] It should also be noted that in relation to the manner of performance and the steps to be taken in the event of defective performance, the English court may have regard to the law of the country in which performance takes place.[121] The English court may also give effect to the overriding mandatory provisions of the law of the country where the obligations arising out of the ISDA Master Agreement and Security Document have to be or have been performed, insofar as those overriding mandatory provisions render the performance of the contract unlawful.[122] The chosen law may not be applied to determine certain questions in relation to the existence and validity (including formal validity) of the ISDA Master Agreement and Security Document or any term of it.

Furthermore, in respect of a New York law governed ISDA Master Agreement and the New York Annex, where all other elements relevant to the situation at the time of the choice are located in one or more EU member states, the fact that the parties have chosen New York law as the governing law of the ISDA Master Agreement (and therefore the New York Annex) will not prejudice the application of provisions of European Union law, where appropriate as implemented in England, which cannot be derogated from by contract.[123] Another exception is that the choice of New York law will not restrict the application of overriding mandatory provisions of English law.[124] The chosen law (or a rule of that law) may also be disapplied if its application would be manifestly incompatible with the public policy of English law.[125]

We know no reason under the current laws of England as to why the choice of New York law as the governing law of an ISDA Master Agreement and the New York Annex should be contrary to English public policy or incompatible with the mandatory rules of the laws of England.[126]

It is difficult to envisage a practical example where the English courts would entirely refuse to uphold an express choice of English law in respect of the English Deed or New York law in respect of an ISDA Master Agreement and New York Annex. A more likely scenario is that the effect of a contract might be modified, or the chosen law displaced, by overriding rules of foreign (or English law) which apply pursuant to the rules outlined above.

Note that we give no opinion on whether the choice of law will be upheld as a valid choice by the courts of England if any contractual obligation arising is outside the scope of Rome I.

Submission to jurisdiction – English Deed

The submission in the English Deed of the parties to the jurisdiction of the English courts is

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120 Article 3(3) of Rome I

121 Article 12(2) of Rome I

122 Article 9(3) of Rome I.

123 Article 3(4) of Rome I.

124 Article 9(2) of Rome I, although it refers to "overriding mandatory provisions".

125 Article 21 of Rome I.

126 The question as to whether any *term* of New York law (as opposed to the choice of New York law) is contrary to English public policy or incompatible with the mandatory rules of the laws of England is outside the scope of this memorandum.

effective. However, an English court may decline jurisdiction or stay or dismiss proceedings before it if it considers that:

(i) it is not the appropriate forum;

(ii) earlier or concurrent proceedings (including related proceedings) have been commenced elsewhere or the claimant has waived its right to rely on the jurisdiction clause;

(iii) another court has exclusive jurisdiction under Regulation (EU) No 1215/2012[127], the Brussels Convention of 1968 or the Lugano Convention of 2007 (each as enacted into English law) or any other international or European regulations or conventions or as otherwise provided for under the Civil Jurisdiction and Judgments Act 1982; or.

(iv) there is no effective jurisdiction agreement between the parties.

The jurisdiction clause in the English Deed states that 'With respect to any suit, action or proceedings relating to this Deed, each party irrevocably submits to the jurisdiction of the English courts'. Under Regulation (EU) No 1215/2012 or the Lugano Convention of 2007 unless the parties have specified that a jurisdiction clause is non-exclusive, the submission is generally deemed to be exclusive.[128] The Brussels Convention now has a limited scope of applicability. Under the common law, if applicable, whether or not the submission to the jurisdiction in the English Deed is exclusive is a question of construction.

Submission to jurisdiction – New York Annex

In respect of a New York law governed ISDA Master Agreement (and therefore the New York Annex), an English court will generally respect the submission by the parties to the jurisdiction of the New York courts. However, an English court may accept jurisdiction or refuse to stay or dismiss proceedings before it in relation to a New York law governed ISDA Master Agreement and New York Annex if it considers that:

(i) it is the appropriate forum to hear the proceedings;

(ii) the defendant has taken steps in the proceedings or otherwise waived its right to rely on the jurisdiction clause;

(iii) it has jurisdiction under Regulation (EU) No 1215/2012, the Brussels Convention of 1968 or the Lugano Convention of 2007 (each as enacted into English law) or any other international or European regulations or conventions or as otherwise provided for under the Civil Jurisdiction and Judgments Act 1982 and, moreover, if it has jurisdiction under these instruments, there may be circumstances where it has no discretion to decline jurisdiction or, if it does have a discretion, where it may nevertheless decide to hear the proceedings; or

(iv) there is no effective jurisdiction agreement between the parties.

Consequences if the parties' agreement on the governing law and their submission to jurisdiction were not upheld by an English court

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127 The Recast Brussels Regulation.

128 Article 25(1) provides in relation to an Article 25 jurisdiction clause "Such jurisdiction shall be exclusive unless the parties have agreed otherwise."

Subject to the discussions above, if the parties' agreement on the governing law and their submission to jurisdiction were not upheld, the relevant Security Document would have to be examined by an English court on the basis of English law.

20. *Are there any other local law considerations that you would recommend the Secured Party to consider in connection with taking and realizing upon the Eligible Collateral from the Security Collateral Provider?*

<u>The EC Insolvency Regulation</u>

The EC Insolvency Regulation[129] came into effect on 31 May 2002. Being a Regulation (rather than a Directive), it has direct effect in all European Union member states[130] without the need for implementing legislation, other than in Denmark, which opted out of relevant sections of the various European Treaties. Since 31 May 2002, to the extent that any provisions of insolvency legislation in a member state are inconsistent with the EC Insolvency Regulation, they have ceased to be applicable.

The EC Insolvency Regulation applies to certain court-based, collective insolvency proceedings affecting a natural person or a legal person, other than credit institutions (banks and building societies), insurance undertakings, investment undertakings which provide services involving the holding of funds or securities for third parties, and collective investment undertakings. Credit institutions, certain investment undertakings and insurance undertakings are the subject of separate European Directives with similar provisions. Note that certain group companies of such entities may also be subject to the separate regime (as discussed at Annex 4).

The EC Insolvency Regulation is not intended to achieve a wholesale harmonisation of insolvency laws but instead to improve the efficiency and effectiveness of insolvency proceedings with a European cross-border element.

Where the EC Insolvency Regulation applies, it will determine the European Union member state(s) in which insolvency proceedings can be commenced and the law that will generally govern those insolvency proceedings (subject to a number of exceptions). It envisages three different types of insolvency proceedings:

(a) "**Main proceedings**" (of which there can only be one set within the European Union) can be opened in the member state in which the debtor has its "centre of main interests" (see below). These can either be winding up or reorganisation proceedings (as listed for each member state in Annex A of the EC Insolvency Regulation). The legal effects of the main proceedings must be recognised in all other member states (unless "secondary proceedings" have been commenced in that member state). The office-holder appointed in the main proceedings must also be recognised and will be able to exercise his or her powers in other member states without the need for a further court order.

(b) "**Secondary proceedings**" (or ancillary proceedings) can be opened in any member state in which the debtor has an "establishment" (see below). The effects of these types of proceedings will be limited to the assets in the member state where the

129 Council Regulation (EC) 1346/2000 of 29 May 2000 on insolvency proceedings.

130 The member states of the European Union are: Austria, Belgium, Bulgaria, Croatia, Republic of Cyprus, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden and the United Kingdom.

secondary proceedings are opened and the types of proceedings available are limited to the winding up proceedings listed in Annex B of the EC Insolvency Regulation.

(c) It may be possible to commence insolvency proceedings on the basis of an establishment *before* the main proceedings have been opened in which case the proceedings are referred to as "**territorial proceedings**". For example, territorial proceedings can be opened if local creditors so request or where main proceedings cannot be opened under the law of the member state where the debtor has his centre of main interests. Such proceedings are not limited to winding up proceedings but an office-holder in the main proceedings may request that any territorial proceedings be converted into winding up proceedings.

Once it has been determined where insolvency proceedings should be commenced, the EC Insolvency Regulation will also determine which law should apply in those proceedings. The general choice of law rule under the EC Insolvency Regulation is that the law of the member state in which proceedings are opened will generally determine all the effects of those proceedings including the conditions for opening the proceedings, their conduct and closure. However, certain exceptions to this general rule (including for rights in rem (discussed further below) and set-off) are intended to "protect legitimate expectations and the certainty of transactions in member states". There are also provisions to regulate and co-ordinate parallel main and secondary proceedings in different member states.

The expressions "centre of main interests" and "establishment" referred to above are obviously key as they will determine whether insolvency proceedings can be commenced in a particular member state. The first test is to establish whether the centre of main interests is in the European Union at all. If it is, it will be possible to commence main proceedings in the member state in which the debtor has its centre of main interests and secondary (or, in certain limited cases, territorial) proceedings in any member state in which the debtor has an establishment.

There is a rebuttable presumption in Article 3(1), in the case of a company, that the centre of main interests is the place of the registered office. Recital (13) of the EC Insolvency Regulation also states that "the centre of main interests should correspond to the place where the debtor conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties".

Prior to the EC Insolvency Regulation, it was generally believed that the English court did not have jurisdiction to make an administration order in relation to a company incorporated outside of England (unless that company was incorporated in a "relevant" country or territory - broadly commonwealth jurisdictions - and a request for assistance was made by the foreign court under section 426 of the Insolvency Act 1986). Cases decided since the EC Insolvency Regulation came into effect suggested that this had changed.[131] The position was clarified by the Insolvency Act 1986 (Amendment) Regulations 2005,[132] and a company incorporated in an EEA State other than the United Kingdom or a company not incorporated in an EEA State but having its centre of main interests in a member state other than Denmark may be placed into administration.

There are no special provisions relating to groups of companies with a number of separately incorporated, subsidiary companies in different member states in the EC Insolvency Regulation. Separate insolvency proceedings may need to be commenced in respect of each

131 *Re Enron Directo SA* (Lightman J, 4 July 2002) and *Re Brac Rent-A-Car International Inc* [2003] 2 All ER 201.

132 SI 2005/879.

company – the "centre of main interests" analysis being applied to each company separately as there are no provisions which allow such companies to enter into a single set of consolidated insolvency proceedings.

The EC Insolvency Regulation does not have a material adverse impact on the collateral arrangements discussed in this memorandum, but is relevant, as outlined above, to the English private international law analysis of a security financial collateral arrangement in the context of a cross-border insolvency.

We have assumed, for the purposes of this opinion, that each English Counterparty has its COMI in England for the purposes of the EC Insolvency Regulation, where it applies. In relation to an English Company, therefore, the location of the main proceedings will be England and English law will govern those proceedings. As discussed above, however, the application of English law is subject to certain derogations one of which is particularly relevant[133] in the context of our analysis of the enforceability of the Security Documents against an English Company as set out in this part III: Article 5 (Third parties' rights in rem) of the EC Insolvency Regulation states that "[t]he opening of insolvency proceedings shall not affect the rights in rem of creditors or third parties in respect of tangible or intangible, moveable or immoveable assets - both specific assets and collections of indefinite assets as a whole which change from time to time - belonging to the debtor which are situated within the territory of another Member State at the time of the opening of proceedings." Article 5(2) clarifies that the rights referred to shall, in particular, mean the right to dispose of assets to obtain satisfaction from the proceeds of or income from those assets, by virtue of a lien or mortgage. Accordingly, where the location[134] of the Collateral is outside England but within the territory of another Member State, the adverse effects of English insolvency law on the rights in rem of the Collateral Taker will be avoided, although Article 5(4) expressly preserves actions for voidness, voidability or unenforceability of legal acts detrimental to all creditors. In particular, this means that the stay on enforcement on administration under Schedule B1 to the Insolvency Act and under Schedule A1 of the Insolvency Act 1986, in relation to a CVA, will not be relevant.

<u>The Cross-Border Insolvency Regulations</u>

The Cross-Border Insolvency Regulations 2006[135] also implement the UNCITRAL Model Law on Cross-Border Insolvency into English law. As with the EC Insolvency Regulation, the scope excludes certain entities including certain credit institutions (banks and building societies) and insurers.

Under the Cross-Border Insolvency Regulations a foreign representative may apply to the English courts for recognition of the foreign insolvency proceedings in which the foreign representative has been appointed. The foreign insolvency proceedings may be foreign main proceedings taken in the state in which the debtor has its centre of main interests or foreign non-main proceedings taking place in a state in which the debtor has an establishment. Upon such recognition being granted there is an automatic stay on (i) the commencement or continuation of actions or proceedings concerning the debtor's assets, rights, obligations or liabilities; (ii) execution against the debtor's assets; and (iii) the transfer, encumbering or other

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133 Other derogations that may be relevant to the issues considered in this memorandum include Article 6 (Set-off), Article 9 (Payment systems and financial markets), Article 13 (Detrimental acts) and Article 14 (Protection of third-party purchasers).

134 Please note, in this context, the reference to the 'location' of the Collateral is not a reference necessarily to the legal jurisdiction governing the proprietary aspects of the Collateral determined in accordance with our answer to question 2. Article 2(g) of the EC Insolvency Regulation provides a definition of 'the Member State in which assets are situated' for the purposes of the Regulation. Precisely how Article 2(g) would apply to determine the location of Collateral, particularly in the form of securities, for the purposes of Article 5 is unclear.

135 SI 2006/1030.

disposal of the debtor's assets. However, the stay (i) does not affect the right to enforce security so long as such rights could be exercised in a winding up in England; (ii) does not prevent the commencement of insolvency proceedings in England although such proceedings would be limited to assets in England; and (iii) is subject to the discretion of the court to modify or terminate the stay. In addition to the automatic stay, discretionary relief may also be granted in respect of main and non-main proceedings but the relief granted should be that which would be available to a court when dealing with domestic insolvency.[136] In addition, no relief may be granted that would be prohibited under Part 3 of the FCA Regulations in an English insolvency (modification of insolvency law) or would interfere with or be inconsistent with any rights of a collateral taker under Part 4 of the FCA Regulations (Right of use and appropriation).

Section 426 of the Insolvency Act 1986

Section 426 of the Insolvency Act 1986 also gives the English courts discretion to give assistance (applying either the English law or the foreign insolvency law) to certain designated countries. Regulation 15A of the FCA Regulations provides that a court shall not, in pursuance of section 426 of the Insolvency Act 1986 or any other enactment or rule of law, recognise or give effect to (a) any order made by a foreign court exercising jurisdiction in relation to insolvency law or (b) any act of a person appointed in such foreign country to discharge any functions under insolvency law in so far as the making of the order or the doing of the act would be prohibited by Part 3 of the FCA Regulations in the case of an English court or a relevant office holder. This provision appears to be intended to ensure that an insolvency order made by a foreign court, or an act by a foreign insolvency office-holder, cannot be enforced by a UK court if such an order or act could not be made by a UK court or office-holder in similar circumstances. However, there may be issues in working out whether the order or act would not have been available to a UK court or office-holder in similar circumstances as this will involve considering whether the foreign insolvency law provisions in question are analogous to the English insolvency law provisions that have been disapplied by the FCA Regulations. If the UK court concludes that they are, no assistance may be granted pursuant to section 426 of the Insolvency Act 1986 (or pursuant to the relevant provisions for recognising foreign insolvency judgments) and so the FCA Regulations may be of assistance. It is worth noting, however, that there is no case law yet on how Regulation 15A would be applied in practice.

Recognition of foreign judgments

The English regime for the recognition of foreign judgments may also be relevant. A foreign judgment would, of course, have no direct operation in England. However, a monetary judgment (i.e. a judgment requiring a party to pay a particular sum of money) would generally be enforceable, subject to certain conditions, in England by action at common law or under a relevant statutory provision by a more direct process of registration, for example under the Administration of Justice Act 1920 or the Foreign Judgments (Reciprocal Enforcement) Act 1933. The latter route is only available to certain countries, different statutes applying for historical reasons to different countries, primarily Commonwealth and European countries. If no statutory provision exists (for example, as is the case in relation to the United States), then the judgment must be enforced under common law principles. Whether a judgment from a country that can be registered under a statutory procedure can instead be enforced under the common law will depend on the relevant jurisdiction as some statutes are the exclusive means of enforcement whilst others may not be.

136 Fibria Celulose S/A v Pan Ocean Co. Ltd [2014] EWHC 2124 (Ch)

In these regards we draw your attention to assumptions (k) and (l) in part I above.

21. *Are there any other circumstances you can foresee that might affect the Secured Party's ability to enforce its security interest in your jurisdiction?*

No.

IV. TITLE TRANSFER

1. Introduction

In this part IV we consider issues relating to the establishment and enforcement of a title transfer collateral arrangement relating to Collateral transferred under the English Transfer Annex under fact patterns (a) and (b) as set out in part I.4 of this memorandum.

Our conclusions in this respect in relation to an English Company apply in relation to:

(a) an English Bank, as modified and supplemented by Annex 1;

(b) an English Investment Firm, as modified and supplemented by Annex 2;

(c) an English Building Society, as modified and supplemented by Annex 3;

(d) a Banking Group Company or a Bank Holding Company, as modified and supplemented by Annex 4;

(e) the Trustee of an English Trust (other than the Trustee of an English Charitable Trust, an English Authorised Unit Trust or any English Trust excluded from the scope of this memorandum under part I.2(b) above), as modified and supplemented by Annex 5;

(f) a Friendly Society, as modified and supplemented by Annex 6;

(g) a C/CB Society, as modified and supplemented by Annex 7;

(h) a Statutory Corporation, as modified and supplemented by Annex 8;

(i) a Chartered Corporation, as modified and supplemented by Annex 9;

(j) an English Insurance Company, as modified and supplemented by Annex 10;

(k) Standard Chartered Bank, as modified and supplemented by Annex 11;

(l) an English Charity acting through the Trustee of an English Charitable Trust, as modified and supplemented by Annex 12;

(m) an English Charity established in one of the other forms indicated above, as modified and supplemented by Annex 13;

(n) an English Investment Fund that is an Open-Ended Investment Company, as modified and supplemented by Annex 14; and

(o) an English Investment Fund acting through the Trustee of an Authorised Unit Trust, as modified and supplemented by Annex 15.

You have also asked us to consider such issues in respect of the Bank of England, which is a Central Bank, and the United Kingdom acting through Her Majesty's Treasury. Each of the Bank of England and the United Kingdom acting through Her Majesty's Treasury requires a separate analysis due to its unique nature.

In this part IV we also consider issues relating to the establishment and enforcement of a title transfer collateral arrangement relating to Collateral transferred under the English Transfer Annex where the Collateral Provider is a Foreign Entity and the Collateral is located in England under fact pattern (c) as set out in part I.4 of this memorandum.

2. Assumptions

For the purpose of this part IV you have asked us to assume the same facts as set forth in part III, but on the assumption that the parties have entered into an English Transfer Annex in connection with an ISDA Master Agreement rather than a Security Document.

For this purpose:

(i) we make the following assumption in place of assumption (a):

(a) The Transferor has entered into an ISDA Master Agreement[137] governed by English law and an English Transfer Annex with the Transferee.

(ii) assumption (d) is deleted;

(iii) assumptions (b) to (k) should be read as modified by the following: references to the "Security Document(s)", "relevant Security Document" or "either Security Document" should be deemed to be references to the "English Transfer Annex"; references to the "Security Collateral Provider" and "Secured Party" should be deemed to be references to "Transferor" and "Transferee", respectively; references to "Eligible Collateral" should be deemed to be references to "Eligible Credit Support" and references to "paragraph 13" should be deemed to be references to "paragraph 11";

(iv) assumption (j) applies to question 25 below as indicated in our answer; and

(v) assumption (k) applies to questions 25 to 27 below.

We note that under the English Transfer Annex, a transfer of Eligible Credit Support is expressed to be an outright transfer of title, and that the transferring party (whether the Transferor in relation to the provision of Collateral, for example, as part of a Delivery Amount, or the Transferee in relation to the return of Collateral, for example, as part of a Return Amount) represents and agrees that it is transferring the Collateral free and clear of any liens, claims, charges or encumbrances or any other interest of the transferring party or of any third person (other than a lien routinely imposed on all securities in a relevant clearance system).

137 Either the 1992 Agreement or the 2002 Agreement.

3. Questions relating to the English Transfer Annex

22. *Would the laws of your jurisdiction characterize each transfer of Eligible Credit Support as effecting an unconditional transfer of ownership in the assets transferred? Is there any risk that any such transfer would be recharacterised as creating a security interest? If so, is there any way to minimize such risk? What would be the specific consequences of such a recharacterisation (referring back to issues related to perfection, priority and formal requirements for establishing both as discussed with regard to the Security Documents in part II above).*

We assume that this question is primarily concerned with transfers by the Transferor to the Transferee of Eligible Credit Support in the form of securities. We will, however, comment briefly on transfers of cash, before considering securities.

Paragraph 3(a)(i) of the English Transfer Annex indicates that a transfer of cash is intended to take effect as an outright payment (as opposed to, say, a payment in trust or the assignment of the benefit of an account). There is nothing elsewhere in the English Transfer Annex to indicate otherwise. A transfer by the Transferor to the Transferee under Paragraph 2(a) or 3(c) of the English Transfer Annex creates a conditional debt obligation of the Transferee to the Transferor. The debt obligation is conditional on the performance by the Transferor of its obligations under the ISDA Master Agreement. The debt is either repaid pursuant to Paragraph 2(b) of the English Transfer Annex or, in the case of a default by the Transferor, included within the close-out netting effected under Section 6(e) of the ISDA Master Agreement.

In the case of securities, in our view, subject to the discussion below, a transfer by the Transferor to the Transferee of securities as Eligible Credit Support under Paragraph 2(a) or 3(c) of the English Transfer Annex would be characterised under English law as a transfer of outright ownership in those securities. Equally, a transfer by the Transferee to the Transferor of securities as Equivalent Credit Support under Paragraph 2(b) or 3(c) would be characterised as a transfer of outright ownership in those securities.

We do not believe that there is a material risk that any such transfer would be recharacterised by an English court as transferring a lesser form of interest in the securities, for example, a security interest, provided that the true intention of the parties is the transfer of outright ownership. Paragraphs 5(a) and 5(b) make it clear that the intention of each party is that each such transfer should effect a transfer of the transferring party's full title to such securities and not merely to create a security interest in such securities. There is no other provision of the English Transfer Annex that is in our view inconsistent with such a characterisation.

On the contrary, we note that in the case of transfers of Eligible Credit Support by the Transferor to the Transferee there is no contractual restriction on the Transferee's right to deal with the securities as it sees fit, including the right to sell such securities or dispose of them in some other manner, and the Transferee is only obliged under Paragraph 2(b) or 3(c), as the case may be, to deliver fungible equivalent securities to the Transferor and not the original securities it received. As a collateral arrangement, the English Transfer Annex relies for its effectiveness on the close-out netting provision of Section 6(e) of the ISDA Master Agreement and not on the exercise by the Transferee of a power of sale or any other remedy of a secured creditor in relation to securities transferred to it.

The question of whether a court might recharacterise a title transfer collateral arrangement of the type exemplified by the English Transfer Annex as a form of mortgage, charge or other form of security interest arises because the purpose and economic effect of such an arrangement is similar to the purpose and economic effect of a security interest. This fact alone, however, is not sufficient to cause an English court to recharacterise the arrangement.[138]

The English courts have considered the question of the characterisation of a transaction as a true sale or as a form of secured financing in a number of different contexts, including sale and repurchase agreements, sale and leaseback arrangements, hire-purchase agreements and receivables financing.[139] The cases show that the English courts accord considerable respect to the characterisation given by the parties themselves and will only recharacterise where the express characterisation is either a sham or at odds with the legal substance of the relations created in the relevant agreement.

Thus, in cases where the court has recharacterised a purported sale as a security interest, there have been features in the agreement inconsistent with an outright transfer of ownership (for example, restrictions on the transferee's ability to deal with the assets and/or a requirement that the transferee deliver the same assets originally transferred rather than merely fungible or equivalent assets).[140] As with the question of categorising fixed and floating charges, it is likely that an English court would apply a two stage test, the first stage of which is ascertaining the nature of the rights and obligations which the parties intended to grant each other. The second stage of the process is one of categorisation of such rights as a matter of law and not of intention.

In our view, there is nothing in the English Transfer Annex that is inconsistent with the stated intention of the parties that each transfer of Eligible Credit Support or Equivalent Credit Support under the English Transfer Annex is intended to be an outright transfer of ownership in the relevant securities.

We assume that the parties, in operating the English Transfer Annex, conduct themselves consistently with the intention expressed above. In other words, we assume that this arrangement is not a sham. Whether or not it is a sham would be a question of fact, but generally speaking it means that parties did not intend to comply with the terms of the express agreement. In other words, some element of fraud or dishonesty is involved.

Alternatively, subsequent conduct of the parties that is inconsistent with each transfer being an outright transfer of ownership could be construed as a variation or abandonment of the original agreement to effect outright transfers of Collateral. This might happen, for example, where, with the agreement of the Transferor, the Transferee segregates the transferred securities, identifies them as in some sense continuing to belong to the Transferor, and/or

138 *Olds Discount Co. Ltd v John Playfair Ltd* [1938] 3 All ER 275; *Bank of Tokyo v Karoon* [1986] 3 All ER 468 at p 486; *Re Polly Peck International plc (in administration) (No 3)* [1996] 1 BCLC 428, at p 439.

139 The leading cases are *Manchester, Sheffield & Lincolnshire Railway Co v The North Central Wagon Company* (1888) 13 App Cas 554, HL; *Re George Inglefield Ltd* [1933] Ch1; *Re Curtain Dream plc* [1990] BCLC 925; *Welsh Development Agency v Export Finance Co Ltd* [1992] BCLC 148; *Orion Finance v Crown Management Ltd* [1996] BCC 621, CA. See also in the context of repos and stock lending see *Pearson v Lehman Brothers Finance SA* [2010] EWHC 2914 (Ch) [78]-[82] and *Mills v Sportsdirect.com Retail Ltd* [2010] EWHC 1072 and the Australian cases *Beconwood Securities Pty Ltd v Australia and New Zealand Banking Group Limited* [2008] FCA 594 and the majority judgments in *ABN AMRO Clearing Sydney Pty Ltd v Primebroker Securities Limited* [2012] VSCA 287. For a good discussion of the approach of the English courts to the question of characterisation in these and similar contexts, see McKendrick E, *Goode on Commercial Law* (4th edition, 2010) at pp 645-650. Specifically in the context of title transfer collateral arrangements, see also the excellent discussion of these issues in Joanna Benjamin, *Interests in Securities* (2000) at pp 132-134. Dr Benjamin discusses the cases mentioned above along with a number of others. See also H Beale and others, *The law of Security and Title-Based Financing* (2nd edition, OUP 2012), para 4.30.

140 See for example, the *Curtain Dream* case cited above. Also, *Ex parte Odell* (1878) 10 ChD 76. *Smith (Administrator of Cosslett (Contractors) Ltd v Bridgend County Council* [2001] UKHL 58, also falls into this category. Leading counsel confirmed at the time that the *Cosslett Contractors* case did not change the analysis applicable to genuine title transfer collateral arrangements of the type exemplified by the English Transfer Annex.

does not otherwise deal with the securities as it would with its own property. Again, whether or not this is the case is a question of fact.

Ultimately, all the relevant facts of each individual case must be taken in to account in determining the true intention of the parties and whether or not, in that context, whether due to contractual restrictions on the ability of the Transferee to deal freely with securities transferred as Eligible Credit Support or for any other reason, a risk of recharacterisation arises.

An important substantive difference between a security interest collateral arrangement and a title transfer collateral arrangement is that, in the former case, the Collateral Provider remains, subject to the encumbrance it has created, the owner of the assets delivered as Collateral. This means that in the event of the insolvency of the Collateral Taker, those assets do not form part of the estate of the Collateral Taker and are not available to satisfy the general creditors of the Collateral Taker. (This also assumes that the Collateral Taker has not, either fraudulently, negligently, or honestly pursuant to an express power, disposed of such assets to a *bona fide* third party purchaser.)

In the case of a title transfer collateral arrangement, the Collateral Provider has no continuing proprietary interest in the Collateral it provided but merely a conditional personal right against the Collateral Taker to re-delivery of fungible equivalent assets or, in default circumstances, to the value (by payment or set-off) of such assets at the time of the default. This means that in the insolvency of the Collateral Taker, the Collateral Provider is an unsecured creditor and therefore has credit risk on the Collateral Taker to the extent that the Collateral provided exceeds total liabilities owed by the Collateral Provider to the Collateral Taker.

There are therefore clear substantive differences in the legal rights and obligations created by a security interest collateral arrangement relative to a title transfer collateral arrangement, each such arrangement having its relative advantages and disadvantages. In such circumstances, the parties have a genuine choice to make between the two approaches, and therefore the choice of a title transfer collateral arrangement is not a sham.[141]

Having established that a title transfer collateral arrangement is not a sham and that on a proper analysis it effects a substantively different set of legal relations than a security interest collateral arrangement, is there a risk nonetheless that an English court might recharacterise the title transfer arrangement as a form of security interest on the grounds of public policy? If, for example, the primary motivation of the parties entering into the title transfer arrangement were to avoid the Registration Provisions, in circumstances where the FCA Regulations did not apply, might this not be grounds for recharacterising the transaction?

It is clear that where there is a genuine legal difference between two arrangements that otherwise achieve the same or a similar economic effect, there is no general policy of English law that prevents their choosing the arrangement that is more convenient because, for example, it avoids the effect of legislation considered onerous by the parties. In the cases where parties have purported to enter into a fixed charge but the court has held the charge to be floating, entailing a number of inconvenient results, including historically the application of the Registration Provisions that would otherwise not have applied, the court has relied not on some overriding English policy intended to prevent circumvention of the Registration Provisions but on the fact that the charge in legal substance was a floating charge and not a

141 Contrast this with those cases in which the parties have purported to create a fixed charge but analysis of the legal substance of their arrangement shows that they have, in fact, created a floating charge. This issue is discussed above in our response to question 11 above.

fixed one.[142] It is also clear that the English courts do not have any particular bias for security arrangements as opposed to title transfer arrangements. Provided that the parties reflect their true intentions in their contract, they are free to structure their transactions in whichever way they wish.

The foregoing is reinforced by the clear purpose of Article 6 of the Collateral Directive, to the effect that member states must ensure that title transfer collateral arrangements should take effect in accordance with their terms, that is, not be subject to recharacterisation. There is no direct counterpart of this provision in the FCA Regulations, but we understand that this was simply because it was not considered necessary to specifically address recharacterisation risk in the FCA Regulations since the consensus is that the risk is negligible absent special circumstances.

Finally, in relation to Eligible Credit Support located outside England and Wales, it is not clear under current English conflict of laws rules whether an English court would apply such rules to the question of the proper characterisation of a transfer of such Eligible Credit Support under the English Transfer Annex. While it is well-established that an English court will look to the relevant foreign jurisdictions as to the proprietary aspects of a transfer of assets located in such jurisdictions, it is not clear whether this includes the question of characterisation. For a variety of reasons, it seems unlikely that an English court would recharacterise the English Transfer Annex or any other title transfer collateral arrangement governed by English law as a result of recharacterisation under the relevant foreign law. The position, however, is not beyond doubt, and parties are therefore advised to investigate separately whether recharacterisation risk would arise in the jurisdiction of location of the Collateral assets.[143]

23. *Assuming that the Transferee receives an absolute ownership interest in the Eligible Credit Support, will it need to take any action thereafter to ensure that its title therein continues? Are there any filing or perfection requirements necessary or advisable, including taking any of the actions referred to in question 5? Are there any other procedures that must be followed or consents or other governmental or regulatory approvals that must be obtained to establish, enforce or continue such an ownership interest?*

Under English law, there are no ongoing actions of this kind that are required to ensure a continuation of title. There are no filing or perfection requirements of this kind that are necessary or desirable, and no consents or regulatory approvals would be required.

24. *What is the effect, if any, under the laws of your jurisdiction of the right of the Transferor to exchange Eligible Credit Support pursuant to Paragraph 3(c) of the English Transfer Annex? Does the presence or absence of consent to exchange by the Transferee have any bearing on this question? Please comment specifically on whether the Transferor and the Transferee are able validly to agree in the English Transfer Annex that the Transferor may exchange Collateral without specific consent of the Transferee and whether and, if so, how this may affect your conclusions regarding the validity and enforceability of the Transfer Annex.*

In our opinion, the provisions of Paragraph 3(c) of the English Transfer Annex relating to the

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142 See our response to question 11.

143 Some indirect support for the views we have expressed may be found in *British South Africa Co v De Beers Consolidated Mines Ltd* [1910] 1 Ch 353, reversed on other grounds [1912] AC 52 and in *Re Anchor Line (Henderson Bros) Ltd* [1937] 2 All ER 823. These issues are also discussed, but without definitive conclusions being drawn, in a paper entitled "Cross-border securities collateral: redefining recharacterisation risk" delivered by Richard Fentiman, which was published in the proceedings of the Oxford Colloquium on Collateral and Conflict of Laws as a Special Supplement to Butterworths Journal of International Banking and Financial Law (September 1998). These issues are also discussed in Benjamin, op cit, at pp 134-137. Also see Ooi M, *Shares and Other Securities in the Conflict of Laws* (OUP, 2003), para 8.61-8.84.

exchange of Eligible Credit Support do not change the characterisation of the transfers effected under the English Transfer Annex, as each transfer relating to an exchange may equally be characterised as an outright transfer of ownership, as discussed above. We do not believe that the presence or absence of a consent requirement affects this analysis.[144]

25. *The Transferee's rights in relation to the transferred Eligible Credit Support upon the occurrence of an Event of Default will be governed by Section 6 of the ISDA Master Agreement. Assuming that Section 6 of the ISDA Master Agreement is valid and enforceable in your jurisdiction insofar as it relates to the determination of the net amount payable by either party on the termination of the Transactions, could you please confirm that Paragraph 6 of the English Transfer Annex would also be valid to the extent it provides for the Value of the Credit Support Balance to be included in the calculation of the net amount payable under Section 6 (e) of the ISDA Master Agreement.*

Assuming that the Transferee receives an absolute ownership interest in the Collateral, in our opinion, Paragraph 6 of the English Transfer Annex would also be valid to the extent that it provides for the Value of the Credit Support Balance applicable to a Transferor that is an English Company to be included in the calculation of the net amount payable under Section 6(e) of the ISDA Master Agreement. In respect of the commencement of insolvency proceedings in England in respect of an English Branch that is providing Collateral please see Annex 1.

For the reasons given in part III.3(3)(a) of the ISDA Netting Opinion, we believe that the ISDA Master Agreement and all Transactions (including that represented by the English Transfer Annex) may be considered a single agreement between the parties and that a court would construe the close-out netting provisions (as defined in the ISDA Netting Opinion) of the ISDA Master Agreement together with Paragraph 6 of the English Transfer Annex (other than to the extent that these provisions include within the calculation pursuant to Section 6(e) of the ISDA Master Agreement Unpaid Amounts owed by either party that became payable prior to the operation of Section 6(c)(ii) of the ISDA Master Agreement, as discussed in the ISDA Netting Opinion) as not involving contractual set-off but simply as representing an accounting of rights and liabilities under the single agreement following the designation or deemed occurrence of an Early Termination Date. As noted in the ISDA Netting Opinion, this is sometimes referred to as the "flawed asset" approach to contractual netting.

If, however, the court were to construe the close-out netting provisions (together with Paragraph 6 of the English Transfer Annex) as operating by way of contractual set-off rather than pursuant to the "single agreement" (or "flawed asset") approach, we also consider that Paragraph 6 would be valid as a matter of English law. Automatic and mandatory insolvency set-off of mutual credits and mutual debts between the Transferor and the Transferee would occur in a liquidation of the English Company under Rule 4.90 of the Insolvency Rules 1986. Furthermore, in circumstances where an administration is commenced after 15th September, 2003 and the administrator gives notice that he intends to make a distribution to creditors, automatic and mandatory insolvency set-off of mutual credits and mutual debts between the Transferor and the Transferee would occur under Rule 2.85 of the Insolvency Rules 1986. Automatic and mandatory insolvency set-off is subject to a cut-off in respect of debts incurred after a specified date (see the ISDA Netting Opinion for more details).

Note that under Rule 4.91 and Rule 2.86 of the Insolvency Rules 1986, a debt payable in a currency other than pounds sterling must be converted to pounds sterling for purposes of

144 This view was confirmed by leading counsel prior to the implementation of the Collateral Directive in England. H Beale and others (op cit) also notes at paragraph 7.65 in the context of a repo that there seems no reason why a repo agreement should not include a substitution right according to fixed criteria which does not require consent.

proof in the liquidation or administration of a company including for the purpose of mandatory set-off under Rule 4.90 and Rule 2.85. The debt must be converted at the London Foreign Exchange Market's "middle exchange rate" at the close of business on the date when the company went into liquidation or administration or in the absence of any such published rate, such rate as the court determines. Since the London foreign exchange market is not an organised market in the conventional sense, but simply the market constituted by dealings between foreign exchange market dealers based in London between themselves and with wholesale counterparties, it is difficult to construe this Rule.[145] In practice, it is likely that a court would accept a reasonably determined mid-market foreign exchange rate for the relevant date.[146]

If however, the Transferee has exercised any right of set-off prior to the Transferor going into liquidation or administration, then Rule 4.91 and Rule 2.86 will only apply to any net unsecured claim for which the Transferee may wish to prove in the liquidation or administration of the Transferor.

If the English Transfer Annex forms part of a financial collateral arrangement under the FCA Regulations as discussed in part II above, regulation 12 provides that a close-out netting provision shall, subject to paragraph (2), take effect in accordance with its terms notwithstanding that the collateral-provider or collateral-taker under the arrangement is subject to winding-up proceedings or reorganisation measures. In addition, pursuant to the FCA Regulations, where applicable, neither Rule 4.91 nor Rule 2.86 applies in respect of a financial collateral arrangement if the arrangement provides for another method of determining the relevant exchange rate, unless such other method can be said to produce an unreasonable result. As discussed in the ISDA Netting Opinion, in our view, this is intended to protect, for example, the conversion of the value of each Terminated Transaction into the Termination Currency of the ISDA Master Agreement or, in relation to the operation of the English Transfer Annex, both the conversion of the value of any item of Eligible Credit Support comprised in the Credit Support Balance into the Base Currency and the subsequent conversion (if any) of the Unpaid Amount represented by the Value of the Credit Support Balance into the Termination Currency, such that the currency conversions contemplated by Section 6(e) of the ISDA Master Agreement and Paragraph 6 of the English Transfer Annex are not displaced by Rule 4.91.[147] Therefore, the above issues relating to Rules 4.91 and 2.86 should not apply. However, where the Termination Currency is a currency other than Sterling, Rule 4.91 would still apply in order to convert it into Sterling for the purpose of proving the debt.

If the requisite majority of creditors of the Transferor were to approve a voluntary arrangement under the Insolvency Act 1986 or a scheme of arrangement under the Companies Act 2006, this could have the effect of releasing the whole or any part of the Transferee's claim against the Transferor and this could affect the Transferee's ability to exercise its contractual rights to netting or set-off under the English Transfer Annex. The voluntary arrangement or scheme may also contain provisions similar to the mandatory set-off rules referred to above preventing the exercise of set-off rights in respect of debts incurred after a specified date. As a practical matter, however, the Transferee should have sufficient time between notice of the convening of a meeting of creditors to consider proposals for a

145 For example, how does one determine what constitutes the "published rate" for any particular date?

146 In the unreported decision of *Re Kaupthing Singer & Friedlander (In Administration)* (16 June 2009), Lloyd J ordered that the administrators should use the spot exchange rates published by the Bank of England on the date of administration as the "official exchange rate" for the purposes of Rule 2.86.

147 As discussed above, we are of the view that an English court would recognise and give effect to the net amount determined under Section 6(e) of the ISDA Master Agreement (together with Paragraph 6 of the English Transfer Annex) and would not view that provision as a form of contractual set off provision to be displaced by Rule 2.85 or Rule 4.90, as the case may be, in any event, other than potentially in respect of Unpaid Amounts.

voluntary arrangement or to vote on a scheme or arrangement and the actual convening of such a meeting within which to exercise any rights of netting or set-off, at least where the Transferee has a credit monitoring process in place.[148] Regulation 12 of the FCA Regulations discussed above is also relevant in the context of voluntary arrangements under the Insolvency Act 1986.

We assume that the parties will provide that, for the purposes of Paragraph 6, the Valuation Percentage will be 100 per cent for each type of Eligible Credit Support comprised in the Credit Support Balance. If the Valuation Percentage for the purposes of Paragraph 6 is less than 100 per cent, then there is a risk that, in certain circumstances, the operation of Paragraph 6 might offend the English anti-deprivation rule.[149] Whether or not it would offend rule would depend on the specific facts of the particular case.

26. *Would the rights of the Transferee be enforceable in accordance with the terms of the ISDA Master Agreement and the English Transfer Annex, irrespective of the insolvency of the Transferor?*

Assuming that the Transferee receives an absolute ownership interest in the Collateral, the rights of the Transferee would be enforceable in accordance with the terms of the ISDA Master Agreement and the English Transfer Annex, irrespective of the insolvency in England of a Transferor which is an English Company. In respect of the commencement of insolvency proceedings in England in respect of an English Branch that is providing Collateral please see Annex 1.

However, the enforcement freeze imposed upon an administration of the Transferor or in the context of a "small company" voluntary arrangement in respect of the Transferor (as discussed in the answer to question 17 above) might inhibit the ability of the Transferee to take proceedings against the Transferor to recover any shortfall following the closing out and netting of all outstanding Transactions in accordance with the ISDA Master Agreement. The administration or small company voluntary arrangement freeze would not, however, prevent the Transferee from exercising its close-out rights under the ISDA Master Agreement and the English Transfer Annex or from setting off outstanding obligations, nor would it interfere with the ability of the Transferee to sell the securities transferred to it.

The availability of set-off (for example, in relation to intervening claims) is subject to the matters discussed in question 12 above and, in the event of a proposed scheme of arrangement or voluntary arrangement or after the commencement of a liquidation or administration of the Transferor, to the matters discussed in question 25 above.

27. *Will the Transferor (or its administrator, provisional liquidator, conservator, receiver, trustee, custodian or other similar official) be able to recover any transfers of Eligible Credit Support made to the Transferee during a certain "suspect period" preceding the date of the insolvency? If so, how long before the insolvency does this suspect period begin? If such a period exists, would the substitution of Eligible Credit Support by a Counterparty during this period invalidate an otherwise valid transfer assuming the substitute assets are of no greater value than the asset they are replacing? Would the transfer of additional Eligible Credit Support pursuant to the mark-to-market provisions of the English Transfer Annex during the*

148 Note that it is possible that an Event of Default under section 5(a)(vii) may not be triggered in respect of a scheme of arrangement between a company and a single creditor or small group of creditors as opposed to a collective proceeding with creditors generally.

149 See part III.3(3)(a) of the ISDA Netting Opinion for a brief explanation of the anti-deprivation rule and discussion of the leading authority on that rule.

suspect period be subject to avoidance, either because it was considered to relate to an antecedent or pre-existing obligation or for some reason?

The analysis set out in question 18 above would apply equally to transfers of Eligible Credit Support under the English Transfer Annex (although we note that the discussion of *Spread Trustee* is specific to security based documents).

28. *Would the parties' agreement on governing law of the English Transfer Annex and submission to the jurisdiction be upheld in your jurisdiction, and what would be the consequences if it were not?*

Our analysis in the answer to question 19 above applies equally to the English Transfer Annex except that the governing law and jurisdiction clause is set out in the relevant ISDA Master Agreement itself.[150]

29. *Is the English Transfer Annex in an appropriate form to create the intended outright transfer of ownership in the Eligible Credit Support to the Transferee? If there are any other requirements to ensure the validity of such transfer in each type of Eligible Credit Support by the Transferor under the English Transfer Annex, please indicate the nature of such requirements. For example, are there any requirements of the type referred to in question 6?*

The English Transfer Annex is in an appropriate form to create the intended outright transfer of ownership in Eligible Credit Support located in England. There are no particular requirements under English law to ensure the validity of such a transfer. It is simply necessary that the relevant agreement be sufficiently clear and certain as to the intended transfer of title. We believe that the English Transfer Annex is sufficiently clear and certain to reflect such an intention.

Note that if the Eligible Credit Support is located outside England, it would be necessary to ensure that the appropriate local requirements for the validity of the transfer of that Eligible Credit Support have been satisfied.

150 We do not consider in this memorandum whether and in what circumstances the 1992 Agreement or the 2002 Agreement constitute exclusive or non-exclusive jurisdiction clauses.

V. CLOSE-OUT AMOUNT PROTOCOL

We have reviewed the Close-out Amount Protocol and confirm that if a 1992 Agreement between two parties, each of which is a Counterparty falling within the scope of this memorandum, governing Transactions each of which is of a type set out in Appendix A, were amended pursuant to the Close-out Amount Protocol, our conclusions in this memorandum regarding the enforceability of the Credit Support Documents would not be materially affected.

VI. COLLATERAL AGREEMENT NEGATIVE INTEREST PROTOCOL

We have reviewed the ISDA 2014 Collateral Agreement Negative Interest Protocol and confirm that if a Credit Support Document between two parties, each of which is a Counterparty falling within the scope of this memorandum, were amended pursuant to the ISDA 2014 Collateral Agreement Negative Interest Protocol, our conclusions in this memorandum regarding the enforceability of the Credit Support Documents would not be materially affected.

VII. PENDING DEVELOPMENTS

Our views expressed in this memorandum are based on our understanding of English law as in effect on the date of this memorandum. Subject to this, we note that there are a number of pending developments in the form of proposals for English and European legislative changes that may have some impact on our analysis in this memorandum.

The BRRD (as defined in Annex 1) resulted in significant amendments to the Banking Act. Further implementing legislation and standards are expected at the European level – for example (a) the EBA has published draft regulatory technical standards relating to the valuation of derivatives in the context of bail-in and submitted such standards to the Commission for endorsement pursuant to the requirement under Article 49 of the BRRD; and (b) Article 76 of the BRRD relates to safeguards for counterparties in partial property transfers and provides that the European Commission shall adopt delegated acts further specifying the classes of arrangement that are to be protected (to date the EBA has published an opinion on the classes that should be protected). Further developments at the European level may necessitate further changes to the UK framework (such as to the Partial Property Safeguards Order).

In addition further UK developments are expected, including (a) the implementation of Article 96 of the BRRD which requires that resolution authorities have the power to take stand-alone resolution action in respect of a branch of a third country entity; and (b) the PRA and FCA rules implementing Article 55 of the BRRD will apply from 1 January 2016 to derivatives (Article 55 of the BRRD requires that contracts governed by third country laws, such as a New York law governed ISDA Master Agreement include a contractual recognition of bail-in).[151] The PRA has also consulted on a proposed rule which would apply to PRA-authorised UK banks, building societies and PRA-designated UK investment firms as well as qualifying parent undertakings and would prohibit such entities from entering into new obligations or materially amending existing obligations under a financial arrangement unless the counterparty to the financial arrangement agreed to be subject to stays on termination and enforcement of security interests that may apply under English law as a result of resolution. The proposed rule also obliges such firms to ensure that their subsidiaries that are credit institutions, investment firms or financial institutions that are not otherwise caught by the rule (regardless of their jurisdiction of incorporation or establishment) agree with their counterparties under financial arrangements that such counterparties will be subject to similar restrictions. We note that ISDA produced a protocol (the ISDA 2014 Resolution Stay Protocol) in respect of the cross-border recognition of stays under special resolution regimes, which will be amended as of 1 January 2016 by a revised protocol: the ISDA 2015 Universal Resolution Stay Protocol. This Protocol also provides for the contractual recognition of certain property transfers pursuant to resolution including a transfer of interests or obligations under the ISDA Master Agreement entered into between two adhering parties. ISDA is also producing a separate protocol, the ISDA Resolution Stay Jurisdictional Modular Protocol, which is aimed at the buyside and seeks to achieve a substantially similar outcome to Section 1 of the ISDA 2015 Universal Resolution Stay Protocol but is more tailored to the specific legislative or regulatory requirements in different jurisdictions. ISDA is in the process of producing a protocol in respect of contractual recognition of bail-in.

151 On 25 November 2015, the PRA published a "Modification by Consent" to its rules implementing Article 55 in relation to liabilities that are 'phase 2' liabilities, that is, those liabilities subject to the rules on contractual recognition of bail-in from 1 January 2016. The PRA stated that it intends to consult on amending the application of the rules to phase 2 liabilities where compliance is impractical and, while this consultation is prepared and conducted, the rules are modified to delay their application to phase 2 liabilities where impracticable. The PRA has set out the changes to the rules in a modification direction. The modification is valid until the earlier of 30 June 2016 or when the relevant rules are amended or revoked. If a firm wants to take up this modification, it must request to do so by notice to the PRA.

Other areas of legal and regulatory development include the ring-fencing of English banks, the introduction of Solvency II in respect of insurance companies and the Recast EU Insolvency Regulation. Solvency II is due to consolidate and amend a number of European Directives relating to insurance from 1 January 2016 and the Recast EU Insolvency Regulation will govern insolvency proceedings from 26 June 2017 in place of the existing EC Insolvency Regulation.

There is also an on-going reform project to update and replace the Insolvency Rules 1986 with a new set of Insolvency Rules. In July 2015, a final draft of the proposed 2016 Insolvency Rules was published which is now under review by the Insolvency Rules Committee. According to the Insolvency Service, it is anticipated that the final rules will be made in Spring 2016 with a commencement date of 1 October 2016. The published draft 2016 Insolvency Rules include mutual insolvency set-off provisions.

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This memorandum is addressed to ISDA solely for the benefit of its members in relation to their use of the ISDA Master Agreement together with an ISDA Credit Support Document. No other person may rely on this memorandum for any purpose without our prior written consent. This memorandum may, however, be shown by an ISDA member to a competent regulatory or supervisory authority or professional advisors for such ISDA member for the purposes of information only, on the basis that we assume no responsibility to such authority or any other person as a result, or otherwise.

Allen & Overy LLP

ALLEN & OVERY LLP
30 December 2015

CERTAIN TRANSACTIONS UNDER THE ISDA MASTER AGREEMENT

Basis Swap. A transaction in which one party pays periodic amounts of a given currency based on a floating rate and the other party pays periodic amounts of the same currency based on another floating rate, with both rates reset periodically; all calculations are based on a notional amount of the given currency.

Bond Forward. A transaction in which one party agrees to pay an agreed price for a specified amount of a bond of an issuer or a basket of bonds of several issuers at a future date and the other party agrees to pay a price for the same amount of the same bond to be set on a specified date in the future. The payment calculation is based on the amount of the bond and can be physically-settled (where delivery occurs in exchange for payment) or cash-settled (where settlement occurs based on the difference between the agreed forward price and the prevailing market price at the time of settlement).

Bond Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to purchase (in the case of a call) or sell (in the case of a put) a specified amount of a bond of an issuer, such as Kingdom of Sweden or Unilever N.V., at a specified strike price. The bond option can be settled by physical delivery of the bonds in exchange for the strike price or may be cash settled based on the difference between the market price of the bonds on the exercise date and the strike price.

Bullion Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to purchase (in the case of a call) or sell (in the case of a put) a specified number of Ounces of Bullion at a specified strike price. The option may be settled by physical delivery of Bullion in exchange for the strike price or may be cash settled based on the difference between the market price of Bullion on the exercise date and the strike price.

Bullion Swap. A transaction in which one party pays periodic amounts of a given currency based on a fixed price or a fixed rate and the other party pays periodic amounts of the same currency or a different currency calculated by reference to a Bullion reference price (for example, Gold-COMEX on the COMEX Division of the New York Mercantile Exchange) or another method specified by the parties. Bullion swaps include cap, collar or floor transactions in respect of Bullion.

Bullion Trade. A transaction in which one party agrees to buy from or sell to the other party a specified number of Ounces of Bullion at a specified price for settlement either on a "spot" or two-day basis or on a specified future date. A Bullion Trade may be settled by physical delivery of Bullion in exchange for a specified price or may be cash settled based on the difference between the market price of Bullion on the settlement date and the specified price.

For purposes of Bullion Trades, Bullion Options and Bullion Swaps, "Bullion" means gold, silver, platinum or palladium and "Ounce" means, in the case of gold, a fine troy ounce, and in the case of silver, platinum and palladium, a troy ounce (or in the case of reference prices not expressed in Ounces, the relevant Units of gold, silver, platinum or palladium).

Buy/Sell-Back Transaction. A transaction in which one party purchases a security (in consideration for a cash payment) and agrees to sell back that security (or in some cases an equivalent security) to the other party (in consideration for the original cash payment plus a premium).

Cap Transaction. A transaction in which one party pays a single or periodic fixed amount and the other party pays periodic amounts of the same currency based on the excess, if any, of a specified floating rate (in the case of an interest rate cap), rate or index (in the case of an economic statistic cap) or commodity price (in the case of a commodity cap) in each case that is reset periodically over a specified per annum rate (in the case of an interest rate cap), rate or index (in the case of an economic statistic cap) or commodity price (in the case of a commodity cap).

Collar Transaction. A collar is a combination of a cap and a floor where one party is the floating rate, floating index or floating commodity price payer on the cap and the other party is the floating rate, floating index or floating commodity price payer on the floor.

Commodity Forward. A transaction in which one party agrees to purchase a specified quantity of a commodity at a future date at an agreed price, and the other party agrees to pay a price for the same quantity to be set on a specified date in the future. A Commodity Forward may be settled by the physical delivery of the commodity in exchange for the specified price or may be cash settled based on the difference between the agreed forward price and the prevailing market price at the time of settlement.

Commodity Index Transaction. A transaction, structured in the form of a swap, cap, collar, floor, option or some combination thereof, between two parties in which the underlying value of the transaction is based on a rate or index based on the price of one or more commodities.

Commodity Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to purchase (in the case of a call) or sell (in the case of a put) a specified quantity of a commodity at a specified strike price. The option can be settled either by physically delivering the quantity of the commodity in exchange for the strike price or by cash settling the option, in which case the seller of the option would pay to the buyer the difference between the market price of that quantity of the commodity on the exercise date and the strike price.

Commodity Swap. A transaction in which one party pays periodic amounts of a given currency based on a fixed price and the other party pays periodic amounts of the same currency based on the price of a commodity, such as natural gas or gold, or a futures contract on a commodity (e.g., West Texas Intermediate Light Sweet Crude Oil on the New York Mercantile Exchange); all calculations are based on a notional quantity of the commodity.

Contingent Credit Default Swap. A Credit Default Swap Transaction under which the calculation amounts applicable to one or both parties may vary over time by reference to the mark-to-market value of a hypothetical swap transaction.

Credit Default Swap Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to enter into a Credit Default Swap.

Credit Default Swap. A transaction in which one party pays either a single fixed amount or periodic fixed amounts or floating amounts determined by reference to a specified notional amount, and the other party (the credit protection seller) pays either a fixed amount or an amount determined by reference to the value of one or more loans, debt securities or other financial instruments (each a "Reference Obligation") issued, guaranteed or otherwise entered into by a third party (the "Reference Entity") upon the occurrence of one or more specified credit events with respect to the Reference Entity (for example, bankruptcy or payment default). The amount payable by the credit protection seller is typically determined based upon the market value of one or more debt securities or other debt instruments issued, guaranteed or otherwise entered into by the Reference Entity. A Credit Default Swap may also be physically settled by payment of a specified fixed amount by one party against delivery of specified obligations ("Deliverable Obligations") by the other party. A Credit Default

Swap may also refer to a "basket" (typically ten or less) or a "portfolio" (eleven or more) of Reference Entities or may be an index transaction consisting of a series of component Credit Default Swaps.

Credit Derivative Transaction on Asset-Backed Securities. A Credit Default Swap for which the Reference Obligation is a cash or synthetic asset-backed security. Such a transaction may, but need not necessarily, include "pay as you go" settlements, meaning that the credit protection seller makes payments relating to interest shortfalls, principal shortfalls and write-downs arising on the Reference Obligation and the credit protection buyer makes additional fixed payments of reimbursements of such shortfalls or write-downs.

Credit Spread Transaction. A transaction involving either a forward or an option where the value of the transaction is calculated based on the credit spread implicit in the price of the underlying instrument.

Cross Currency Rate Swap. A transaction in which one party pays periodic amounts in one currency based on a specified fixed rate (or a floating rate that is reset periodically) and the other party pays periodic amounts in another currency based on a floating rate that is reset periodically. All calculations are determined on predetermined notional amounts of the two currencies; often such swaps will involve initial and or final exchanges of amounts corresponding to the notional amounts.

Currency Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to purchase (in the case of a call) or sell (in the case of a put) a specified amount of a given currency at a specified strike price.

Currency Swap. A transaction in which one party pays fixed periodic amounts of one currency and the other party pays fixed periodic amounts of another currency. Payments are calculated on a notional amount. Such swaps may involve initial and or final payments that correspond to the notional amount.

Economic Statistic Transaction. A transaction in which one party pays an amount or periodic amounts of a given currency by reference to interest rates or other factors and the other party pays or may pay an amount or periodic amounts of a currency based on a specified rate or index pertaining to statistical data on economic conditions, which may include economic growth, retail sales, inflation, consumer prices, consumer sentiment, unemployment and housing.

Emissions Allowance Transaction. A transaction in which one party agrees to buy from or sell to the other party a specified quantity of emissions allowances or reductions at a specified price for settlement either on a "spot" basis or on a specified future date. An Emissions Allowance Transaction may also constitute a swap of emissions allowances or reductions or an option whereby one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to receive a payment equal to the amount by which the specified quantity of emissions allowances or reductions exceeds or is less than a specified strike. An Emissions Allowance Transaction may be physically settled by delivery of emissions allowances or reductions in exchange for a specified price, differing vintage years or differing emissions products or may be cash settled based on the difference between the market price of emissions allowances or reductions on the settlement date and the specified price.

Equity Forward. A transaction in which one party agrees to pay an agreed price for a specified quantity of shares of an issuer, a basket of shares of several issuers or an equity index at a future date and the other party agrees to pay a price for the same quantity and shares to be set on a specified date in the future. The payment calculation is based on the number of shares and can be physically-settled (where delivery occurs in exchange for payment) or cash-settled (where settlement occurs based on the difference between the agreed forward price and the prevailing market price at the time of settlement).

Equity Index Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to receive a payment equal to the amount by which an equity index either exceeds (in the case of a call) or is less than (in the case of a put) a specified strike price.

Equity Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to purchase (in the case of a call) or sell (in the case of a put) a specified number of shares of an issuer or a basket of shares of several issuers at a specified strike price. The share option may be settled by physical delivery of the shares in exchange for the strike price or may be cash settled based on the difference between the market price of the shares on the exercise date and the strike price.

Equity Swap. A transaction in which one party pays periodic amounts of a given currency based on a fixed price or a fixed or floating rate and the other party pays periodic amounts of the same currency or a different currency based on the performance of a share of an issuer, a basket of shares of several issuers or an equity index, such as the Standard and Poor's 500 Index.

Floor Transaction. A transaction in which one party pays a single or periodic amount and the other party pays periodic amounts of the same currency based on the excess, if any, of a specified per annum rate (in the case of an interest rate floor), rate or index level (in the case of an economic statistic floor) or commodity price (in the case of a commodity floor) over a specified floating rate (in the case of an interest rate floor), rate or index level (in the case of an economic statistic floor) or commodity price (in the case of a commodity floor).

Foreign Exchange Transaction. A deliverable or non-deliverable transaction providing for the purchase of one currency with another currency providing for settlement either on a "spot" or two-day basis or a specified future date.

Forward Rate Transaction. A transaction in which one party agrees to pay a fixed rate for a defined period and the other party agrees to pay a rate to be set on a specified date in the future. The payment calculation is based on a notional amount and is settled based, among other things, on the difference between the agreed forward rate and the prevailing market rate at the time of settlement.

Freight Transaction. A transaction in which one party pays an amount or periodic amounts of a given currency based on a fixed price and the other party pays an amount or periodic amounts of the same currency based on the price of chartering a ship to transport wet or dry freight from one port to another; all calculations are based either on a notional quantity of freight or, in the case of time charter transactions, on a notional number of days.

Fund Option Transaction: A transaction in which one party grants to the other party (for an agreed payment or other consideration) the right, but not the obligation, to receive a payment based on the redemption value of a specified amount of an interest issued to or held by an investor in a fund, pooled investment vehicle or any other interest identified as such in the relevant Confirmation (a "Fund Interest"), whether i) a single class of Fund Interest of a Single Reference Fund or ii) a basket of Fund Interests in relation to a specified strike price. The Fund Option Transactions will generally be cash settled (where settlement occurs based on the excess of such redemption value over such specified strike price (in the case of a call) or the excess of such specified strike price over such redemption value (in the case of a put) as measured on the valuation date or dates relating to the exercise date).

Fund Forward Transaction: A transaction in which one party agrees to pay an agreed price for the redemption value of a specified amount of i) a single class of Fund Interest of a Single Reference Fund or ii) a basket of Fund Interests at a future date and the other party agrees to pay a price for the redemption value of the same amount of the same Fund Interests to be set on a specified date in the future. The payment calculation is based on the amount of the redemption value relating to such Fund Interest and generally cash-settled (where settlement occurs based on the difference between the agreed forward price and the redemption value measured as of the applicable valuation date or dates).

Fund Swap Transaction: A transaction a transaction in which one party pays periodic amounts of a given currency based on a fixed price or a fixed rate and the other party pays periodic amounts of the same currency based on the redemption value of i) a single class of Fund Interest of a Single Reference Fund or ii) a basket of Fund Interests.

Interest Rate Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to receive a payment equal to the amount by which an interest rate either exceeds (in the case of a call option) or is less than (in the case of a put option) a specified strike rate.

Interest Rate Swap. A transaction in which one party pays periodic amounts of a given currency based on a specified fixed rate and the other party pays periodic amounts of the same currency based on a specified floating rate that is reset periodically, such as the London inter-bank offered rate; all calculations are based on a notional amount of the given currency.

Longevity/Mortality Transaction. (a) A transaction employing a derivative instrument, such as a forward, a swap or an option, that is valued according to expected variation in a reference index of observed demographic trends, as exhibited by a specified population, relating to aging, morbidity, and mortality/longevity, or (b) A transaction that references the payment profile underlying a specific portfolio of longevity- or mortality- contingent obligations, e.g. a pool of pension liabilities or life insurance policies (either the actual claims payments or a synthetic basket referencing the profile of claims payments).

Physical Commodity Transaction. A transaction which provides for the purchase of an amount of a commodity, such as oil including oil products, coal, electricity or gas, at a fixed or floating price for actual delivery on one or more dates.

Property Index Derivative Transaction. A transaction, often structured in the form of a forward, option or total return swap, between two parties in which the underlying value of the transaction is based on a rate or index based on residential or commercial property prices for a specified local, regional or national area.

Repurchase Transaction. A transaction in which one party agrees to sell securities to the other party and such party has the right to repurchase those securities (or in some cases equivalent securities) from such other party at a future date.[152]

Securities Lending Transaction. A transaction in which one party transfers securities to a party acting as the borrower in exchange for a payment or a series of payments from the borrower and the borrower's obligation to replace the securities at a defined date with identical securities.[153]

152 We assume, for this purpose, that under the Repurchase Transaction, the original seller's right to repurchase securities is limited to fungible securities and that it has no right to repurchase the exact same securities that it originally sold. This assumption is consistent with market practice, as far as we are aware, in relation to securities repurchase transactions governed by English law, and is necessary to avoid a risk that the transaction might otherwise be characterised by an English court as a secured loan.

153 For the reasons set out in the note above relating to the definition of "Repurchase Transaction", we assume that the reference to identical securities is to be construed as a reference to "fungible" securities rather than the exact same securities originally lent to

Swap Deliverable Contingent Credit Default Swap. A Contingent Credit Default Swap under which one of the Deliverable Obligations is a claim against the Reference Entity under an ISDA Master Agreement with respect to which an Early Termination Date (as defined therein) has occurred.

Swap Option. A transaction in which one party grants to the other party the right (in consideration for a premium payment), but not the obligation, to enter into a swap with certain specified terms. In some cases the swap option may be settled with a cash payment equal to the market value of the underlying swap at the time of the exercise.

Total Return Swap. A transaction in which one party pays either a single amount or periodic amounts based on the total return on one or more loans, debt securities or other financial instruments (each a "Reference Obligation") issued, guaranteed or otherwise entered into by a third party (the "Reference Entity"), calculated by reference to interest, dividend and fee payments and any appreciation in the market value of each Reference Obligation, and the other party pays either a single amount or periodic amounts determined by reference to a specified notional amount and any depreciation in the market value of each Reference Obligation.

A total return swap may (but need not) provide for acceleration of its termination date upon the occurrence of one or more specified events with respect to a Reference Entity or a Reference Obligation with a termination payment made by one party to the other calculated by reference to the value of the Reference Obligation.

Weather Index Transaction. A transaction, structured in the form of a swap, cap, collar, floor, option or some combination thereof, between two parties in which the underlying value of the transaction is based on a rate or index pertaining to weather conditions, which may include measurements of heating, cooling, precipitation and wind.

the borrower. Again, this assumption is consistent, as far as we are aware, with market practice in relation to securities lending transactions governed by English law.

CERTAIN COUNTERPARTY TYPES

Description	Covered[154]	Legal form(s)[155]
Bank/Credit Institution. A legal entity, which may be organized as a corporation, partnership or in some other form, that conducts commercial banking activities, that is, whose core business typically involves (a) taking deposits from private individuals and/or corporate entities and (b) making loans to private individual and/or corporate borrowers. This type of entity is sometimes referred to as a "commercial bank" or, if its business also includes investment banking and trading activities, a "universal bank". (If the entity only conducts investment banking and trading activities, then it falls within the "Investment Firm/Broker Dealer" category below.) This type of entity is referred to as a "credit institution" in European Union (**EU**) legislation. This category may include specialised types of bank, such as a mortgage savings bank (provided that the relevant entity accepts deposits and makes loans), or such an entity may be considered in the local jurisdiction to constitute a separate category of legal entity (as in the case of a building society in the United Kingdom (**UK**)).	Yes	English Company[156]
Central Bank. A legal entity that performs the function of a central bank for a Sovereign or for an area of monetary union (as in the case of the European Central Bank in respect of the euro zone).	Yes, but only in relation to the Central Bank of the United Kingdom	Chartered Corporation

154 This column indicates whether an entity of the relevant type falls within the scope of this memorandum. Where the answer is "No", this is due to the fact that to include this type of entity would require substantial additional legal analysis, beyond the scope of our current instructions.

155 This column indicates the legal form in which an entity of the relevant type is typically organised in England under English law. While it is possible, in some cases, that an entity falling within the commercial description in the left-hand column could organised in a different legal form in England, any such entity would not fall within the scope of this memorandum, unless expressly provided to the contrary. For example, an investment firm organised as a limited liability partnership is not within the scope of this memorandum. A capitalised term used in this column has, unless context indicates otherwise, the meaning given to that term in this memorandum.

156 There are various forms of English Company, including a public limited company, a private company with limited liability, a private company with unlimited liability and a private company limited by guarantee. Our conclusions in this memorandum apply to each type of English Company. The naming conventions for English Companies are set out in sections 58(1) and 59(1) of the Companies Act 2006. An English Company that is a public limited company must have a name that ends with the words "public limited company" or the abbreviation "plc". A private company with limited liability or limited by guarantee must have a name ending with the word "Limited" or the abbreviation "ltd". In either case, the abbreviation may be all upper case, all lower case, with an initial upper case letter only and with or without full stops between the letters (in the case of "plc"). A private company with unlimited liability is not required to have any specific word or abbreviation at the end of its name. In the case of a company registered under the Companies Act 2006 with its registered office in Wales, the name of the company may end with the Welsh equivalents of these terms.

Description	Covered[154]	Legal form(s)[155]
Corporation. A legal entity that is organized as a corporation or company rather than a partnership, is engaged in industrial and/or commercial activities and does not fall within one of the other categories in this Appendix B.	Yes	English Company
Hedge Fund/Proprietary Trader. A legal entity, which may be organized as a corporation, partnership or in some other legal form, the principal business of which is to deal in and/or manage securities and/or other financial instruments and/or otherwise to carry on an investment business predominantly or exclusively as principal for its own account.	Yes	English Company
Insurance Company. A legal entity, which may be organised as a corporation, partnership or in some other legal form (for example, a friendly society or industrial & provident society in the UK), that is licensed to carry on insurance business, and is typically subject to a special regulatory regime and a special insolvency regime in order to protect the interests of policyholders.	Yes	English Company, Friendly Society, C/CB Society, Statutory Corporation, Chartered Corporation
International Organization. An organization of Sovereigns established by treaty entered into between the Sovereigns, including the International Bank for Reconstruction and Development (the World Bank), regional development banks and similar organizations established by treaty.	No	
Investment Firm/Broker Dealer. A legal entity, which may be organized as a corporation, partnership or in some other form, that does not conduct commercial banking activities but deals in and/or manages securities and/or other financial instruments as an agent for third parties. It may also conduct such activities as principal (but if it does so exclusively as principal, then it most likely falls within the "Hedge Fund/Proprietary Trader" category above.) Its business normally includes holding securities and/or other financial instruments for third parties and operating related cash accounts. This type of entity is referred to as a "broker-dealer" in US legislation and as an "investment firm" in EU legislation.	Yes	English Company
Investment Fund. A legal entity or an arrangement without legal personality (for example, a common	Yes	Open-Ended Investment Company

Description	Covered[154]	Legal form(s)[155]
law trust) established to provide investors with a share in profits or income arising from property acquired, held, managed or disposed of by the manager(s) of the legal entity or arrangement or a right to payment determined by reference to such profits or income. This type of entity or arrangement is referred to as a "collective investment scheme" in EU legislation. It may be regulated or unregulated. It is typically administered by one or more persons (who may be private individuals and/or corporate entities) who have various rights and obligations governed by general law and/or, typically in the case of regulated Investment Funds, financial services legislation. Where the arrangement does not have separate legal personality, one or more representatives of the Investment Fund (for example, a trustee of a unit trust) contract on behalf of the Investment Fund, are owed the rights and owe the obligations provided for in the contract and are entitled to be indemnified out of the assets comprised in the arrangement.		Authorised Unit Trust (acting through its Trustee)
<u>Local Authority</u>. A legal entity established to administer the functions of local government in a particular region within a Sovereign or State of a Federal Sovereign, for example, a city, county, borough or similar area.	No	
<u>Partnership</u>. A legal entity or form of arrangement without legal personality that is (a) organised as a general, limited or some other form of partnership and (b) does not fall within one of the other categories in this Appendix B. If it does not have legal personality, it may nonetheless be treated as though it were a legal person for certain purposes (for example, for insolvency purposes) and not for other purposes (for example, tax or personal liability).	No	
<u>Pension Fund</u>. A legal entity or an arrangement without legal personality (for example, a common law trust) established to provide pension benefits to a specific class of beneficiaries, normally sponsored by an employer or group of employers. It is typically administered by one or more persons (who may be private individuals and/or corporate entities) who have various rights and obligations governed by pensions legislation. Where the arrangement does not have separate legal personality, one or more representatives of the Pension Fund (for	No	

Description	Covered[154]	Legal form(s)[155]
example, a trustee of a pension scheme in the form of a common law trust) contract on behalf of the Pension Fund and are owed the rights and owe the obligations provided for in the contract and are entitled to be indemnified out of the assets comprised in the arrangement.		
Sovereign. A sovereign nation state recognized internationally as such, typically acting through a direct agency or instrumentality of the central government without separate legal personality, for example, the ministry of finance, treasury or national debt office. This category does not include a State of a Federal Sovereign or other political sub-division of a sovereign nation state if the sub-division has separate legal personality (for example, a Local Authority) and it does not include any legal entity owned by a sovereign nation state (see "Sovereign-owned Entity").	Yes, but only in relation to the United Kingdom acting through Her Majesty's Treasury in respect of the English Transfer Annex	
Sovereign Wealth Fund. A legal entity, often created by a special statute and normally wholly owned by a Sovereign, established to manage assets of or on behalf of the Sovereign, which may or may not hold those assets in its own name. Such an entity is often referred to as an "investment authority". For certain Sovereigns, this function is performed by the Central Bank, however for purposes of this Appendix B the term "Sovereign Wealth Fund" excludes a Central Bank.	No	
Sovereign-Owned Entity. A legal entity wholly or majority-owned by a Sovereign, other than a Central Bank, or by a State of a Federal Sovereign, which may or may not benefit from any immunity enjoyed by the Sovereign or State of a Federal Sovereign from legal proceedings or execution against its assets. This category may include entities active entirely in the private sector without any specific public duties or public sector mission as well as statutory bodies with public duties (for example, a statutory body charged with regulatory responsibility over a sector of the domestic economy). This category does not include local governmental authorities (see "Local Authority").	An English Company wholly or majority-owned by a sovereign that is active entirely in the private sector with no specific public duties or public sector mission is covered. All other Sovereign-Owned Entities are not covered.	English Company

Description	**Covered**[154]	**Legal form(s)**[155]
State of a Federal Sovereign. The principal political sub-division of a federal Sovereign, such as Australia (for example, Queensland), Canada (for example, Ontario), Germany (for example, Nordrhein-Westfalen) or the United States of America (for example, Pennsylvania). This category does not include a Local Authority.	No	
Banking Group Company and Bank Holding Companies	Yes	English Company
Standard Chartered Bank	Yes	Chartered corporation
English Trust	Yes	English Trust (acting through its Trustee(s))
English Charity	Yes	English Charitable Trust (acting through its Trustee(s)), English Company Friendly Society C/CB Society Statutory Corporation Chartered Corporation
Friendly Society	Yes	Friendly Society
C/CB Society	Yes	C/CB Society
Statutory Corporation	Yes	Statutory Corporation
Chartered Corporation	Yes	Chartered Corporation

APPENDIX C

EXCLUDED ENGLISH COMPANIES

The following types of English Company are excluded from the scope of this memorandum:[157]

(a) water and sewage undertakers under the Water Industry Act 1991;

(b) a qualifying licensed water supplier within the meaning of section 23(6) of the Water Industry Act 1991;

(c) protected railway companies under the Railways Act 1993 (as extended by the Channel Tunnel Rail Link Act 1996);

(d) air traffic services companies under the Transport Act 2000; and

(e) a public-private partnership company under the Greater London Authority Act 1999. [158]

In addition, this memorandum does not consider issues relating to a clearing house organised as an English Company. This is because, among other things, an ISDA Master Agreement entered into between a clearing house and a clearing member is typically so tailored to the specific requirements of the clearing house structure and rules that it requires a separate analysis. More generally we assume that the English Company is not subject to a special regulatory regime not contemplated by this memorandum.

157 Each of these entities is subject to a special insolvency regime as specified in section 249 of the Enterprise Act 2002, which would require a separate analysis from that set out in this memorandum in relation to English Companies generally.

158 Section 249 of the Enterprise Act 2002 also refers to English Building Societies, which are covered by this memorandum, as noted above.

APPENDIX D

RECOURSE TO THE ASSETS OF A TRUST

1. A Trustee's right of recourse to the assets of a trust

A Trustee has statutory and general trust law rights of indemnity[159][160] against a trust for all expenses, and general trust law rights in respect of all liabilities that it incurs in the course of carrying out its duties. For the purpose of giving effect to the indemnity, the Trustee has an interest in the trust assets which is a form of equitable charge and is also known as the Trustee's lien. There may also be an express right of indemnity of the Trustee against the trust assets under the trust deed.[161]

A third party dealing with a Trustee does not have a general non-contractual right of enforcement against the trust assets under statute or common law. There may be an express or implied direct right of recourse for third parties under the trust deed. This is discussed in 2 below. A third party will, however, be subrogated to the Trustee's right of indemnity, but will therefore be vulnerable to any impairment of that right of indemnity as discussed further below.

Should a Trustee need to use trust assets to fulfil a contractual obligation to a third party, the Trustee's exercise of the right of recourse against the trust is subject to the following limitations arising under general equitable principles:

(i) the Trustee must have acted within its powers, that is to say it must have been empowered by statute and by the relevant trust deed to undertake the Transaction in question;

(ii) the Trustee must have exercised those powers prudently for the purpose for which they were conferred and in the interests of the beneficiaries of the trust;

(iii) the Trustee must have taken all relevant considerations into account and no irrelevant considerations; and

(iv) the Trustee must have complied with any internal authorisation and other relevant requirements of the trust as set out in the trust deed.

An important risk when dealing with a Trustee is that the Trustee's right to reimbursement from the trust's assets has been impaired by a breach of trust that is entirely unrelated to the liability for which it is seeking reimbursement. The general principle is that a Trustee may not claim reimbursement from the trust assets to satisfy a contractual liability where it has committed a breach of trust and failed to rectify the breach, assuming it is capable of rectification, regardless of whether the breach was related to the incurring of the liability and even if the breach occurred after the liability was incurred. Impairment of the Trustee's right

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159 Section 31(1) Trustee Act 2000. Also see *Jennings v Mather* [1902] 1 KB1.

160 The terms "right of recourse, "right of indemnity" and "right of reimbursement" are more or less interchangeable in this context, and used as such in this Appendix D.

161 In this Appendix D we use the term "trust deed" for convenience, given that the principal document constituting a trust is normally executed as a deed. We use the term, however, to refer to all the documentation governing the operation of the trust (whether or not executed by deed), including the duties, obligations and rights of the Trustee(s) and the rights of the beneficiaries, whether set out in the trust deed itself or in a related document made pursuant to the trust deed (for example, a document setting out rules for the trust).

of recourse will, therefore, be a continuing risk for any creditor, even if the Transaction giving rise to its claim against the Trustee has been properly entered into.

The fragility of the Trustee's right of recourse to the trust is a serious difficulty for a commercial party wishing to deal with a Trustee. It was partly in recognition of this problem that the Trust Law Committee, discussed further below, was founded.[162] One of the principal aims of the Trust Law Committee has been to consider appropriate law reform measures to make trusts more suitable for use in modern commercial practice. Unfortunately, the difficulty posed by an unrelated breach of trust remains an issue for creditors of Trustees.

2. A third party's right of recourse to the assets of a trust

To protect against the risk that the Trustee's right of recourse has been lost or impaired, or where this has happened, a third party may wish to consider the following:

(a) In circumstances where the third party has enriched or benefited the Trust at its own expense, and it was acting in good faith and did not know that the Trustee was acting beyond its powers, it is possible that the third party may have a direct non-derivative claim in equity, based in the law of restitution, against the trust assets, even in circumstances where the Trustee has exceeded its powers.[163]

The possibility of such a restitution-based claim is referred to in a consultation paper dated April 1997 published by the Trust Law Committee (the **1997 Consultation Paper**). However, we should point out that the precise scope of this claim is still not entirely clear as a matter of English law. The claim would be limited to the extent that the Trust is benefited and may be affected by the defence of change of position, and so we would not recommend that a party rely on the availability of such a claim.

(b) A provision may be added to the ISDA Master Agreement or a Credit Support Document under which the Trustee creates a contractual right for the other party to have direct recourse to the assets of the trust to the extent of the Trustee's liability under the ISDA Master Agreement or Credit Support Document. If valid, this right would be analogous to the Trustee's own right of recourse, without being subject to the limitations as set out in 1 above, and would take priority over the Trustee's right to enforce its indemnity against the trust assets. For such a provision to be effective, the trust deed would need to anticipate and give the Trustee authorisation to confer this direct right of recourse on a third party.

The Trust Law Committee in the 1997 Consultation Paper cites the cases of *ex parte Garland*[164] and *Fairland v Percy*[165] as authority for the proposition that such a direct right of recourse will be effective where the trust instrument anticipates and gives the Trustee authorisation to confer this direct right of recourse. Although these cases are not directly on point, we believe that the better view is that a Trustee can be authorised by the trust deed to confer on a party by contract a direct right of recourse that is analogous to the Trustee's own right of recourse but which is not subject to the same limitations and which takes priority over the Trustee's own lien. We note that the Trust Law Committee was firmly of this view in the

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162 The Trust Law Committee is an *ad hoc* group of leading academics and practitioners dedicated to researching weaknesses of English trust law and ways of improving it. The Trust Law Committee is run under the charitable auspices of King's College London. Further information may be found at http://www.kcl.ac.uk/law/research/centres/trustlawcommittee/index.aspx accessed on 30 December 2015.

163 *Devaynes v Robinson* (1857) 24 Beav 86.

164 (1804) 10 Ves 110.

165 (1875) LR 3 P&D 217.

1997 Consultation Paper, although it did not cite any case law that was directly on point or any other authoritative commentary in the 1997 Consultation Paper.

In the 1997 Consultation Paper, the Trust Law Committee suggested that it may be possible for the contract between the Trustee and a third party to give the third party a direct right of recourse to the trust assets even if the trust deed does not expressly authorise the Trustee to confer such a direct right of recourse, provided that there was nothing in the trust deed which expressly prevented such a right of recourse being given. However, the Trust Law Committee noted that there is no English case law authority to support such a proposition, and we are not aware of any more recent cases that have supported the suggestion in the 1997 Consultation Paper.

The 1997 Consultation Paper was followed in June 1999 by the Trust Law Committee's Report on the Rights of Creditors Against Trustees and Trust Funds (the **1999 Report**). In the 1999 Report, the Trust Law Committee recommended that legislation be passed to the effect that any indebtedness of a Trustee to the trust fund (for example, by reason of breach of trust) should not prevent a creditor from having a right of indemnity out of the trust fund if the Trustee's breach was not connected with the contract with the creditor. However, this proposal was never adopted. In the 1999 Report, the Trust Law Committee repeated its view that, even absent an express power in the trust instrument, an English court may reach the conclusion that a Trustee was able to give a creditor a direct right of indemnity by way of an unsecured right of recourse to the trust fund absent any provision to the contrary in the trust instrument. However, as mentioned above, this is by no means certain and is not yet, as far as we are aware, supported by any English case.

ANNEX 1

BANK

PART 1 – ENGLISH BANK

In Part 1 of this Annex 1, we set out our views regarding the enforceability of the Credit Support Documents in the event that resolution action or insolvency proceedings are commenced in England in respect of an English Bank.

Subject to the more detailed discussion below, the types of insolvency proceedings that may be commenced in England in respect of an English Bank are:

(a) each type of insolvency proceeding that may be commenced in England in relation to an English Company as set out in part III.1(4) of the ISDA Netting Opinion;

(b) the bank insolvency procedure under Part 2 of the Banking Act (the **Bank Insolvency Procedure**);

(c) the bank administration procedure under Part 3 of the Banking Act (the **Bank Administration Procedure**); and

(d) if the English Bank is an investment bank as defined in section 232 of the Banking Act:

   (i) special administration (bank insolvency) under the Investment Bank Special Administration Regulations 2011[166] (**Special Administration (Bank Insolvency)**); and

   (ii) special administration (bank administration) under the Investment Bank Special Administration Regulations 2011 (**Special Administration (Bank Administration)**).

The above list of insolvency proceedings assumes that the English Bank does have eligible depositors[167]. If, in fact, the English Bank has no eligible depositors, the types of insolvency proceedings that may be commenced in England in respect of it are:

(a) each type of insolvency proceeding that may be commenced in England in relation to an English Company as set out in part III.1(4) of the ISDA Netting Opinion;

(b) the Bank Administration Procedure; and

(c) if the English Bank is an investment bank as defined in section 232 of the Banking Act:

   (i) Special Administration (Bank Administration); and

   (ii) investment bank special administration under the Investment Bank Special Administration Regulations 2011 (**Investment Bank Special Administration**).

We also discuss below, in relation to an English Bank, Part 1 of the Banking Act, which establishes the English special resolution regime, and transfer schemes under Part VII of the Financial Services and Markets Act 2000.

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166 SI 2011/245.

167 "Eligible depositors" is defined at section 93(3) of the Banking Act and means depositors who are eligible for compensation under the Financial Services Compensation Scheme (established under Part 15 of the Financial Services and Markets Act 2000).

1. Conclusion

On the basis of the assumptions and subject to the qualifications in this memorandum as modified and supplemented by this Annex 1, we are of the view that our conclusions in this memorandum in relation to an English Company would also apply to an English Bank, including in the event of its becoming subject to: (a) one of the forms of insolvency proceeding under the Insolvency Act 1986; (b) the Bank Insolvency Procedure; (c) the Bank Administration Procedure; (d) Special Administration (Bank Insolvency); (e) Special Administration (Bank Administration); (f) Investment Bank Special Administration; (g) a transfer scheme under Part VII of the Financial Services and Markets Act 2000; or (h) the special resolution regime under Part 1 of the Banking Act.

2. Analysis

The conclusions in paragraph 1 of this Annex are subject to the discussion below.

2.1 *Insolvency proceedings under the Insolvency Act 1986 and scheme of arrangement under the Companies Act 2006*

The insolvency proceedings applicable to an English Company may also apply to an English Bank. However, the FCA and the PRA (the FCA, together with the PRA, the **Regulators**) have certain powers to initiate and to intervene in insolvency proceedings in relation to English Banks.[168] Neither the existence nor the possibility of the exercise by the Regulators of any of these powers would, however, have a material and adverse effect on our conclusions in parts III or IV of this memorandum as they would apply to an English Bank.

2.2 *Part VII of the Financial Services and Markets Act 2000*

Part VII of the Financial Services and Markets Act 2000 sets out provisions for various transfer schemes including banking business transfer schemes and ring-fencing transfer schemes. Insurance business transfer schemes are discussed in Annex 10.[169]

A banking business transfer scheme is a scheme under which the whole or part of the business of an English Bank, including the acceptance of deposits, may be transferred to another body, subject to certain conditions and exclusions.[170] A ring-fencing transfer scheme is a scheme under which the whole or part of the business of a UK authorised person (or of an entity incorporated in the UK that is not authorised but is a member of a group including the UK authorised person) may be transferred to another body, subject to certain conditions and exclusions, for the purpose of complying with the ring-fencing rules and the duty imposed on ring-fenced bodies as to the activities they can carry on. These provisions do not apply to building societies.

A transfer scheme (except in respect of insurance business) does not have to be effected in accordance with these provisions,[171] but if it is, an application is made to the court for an

168 For example see Part XXIV of the Financial Services and Markets Act 2000 and section 120 of the Banking Act.

169 Part VII also includes transfer provisions in respect of 'reclaim funds', being companies incorporated under the Companies Act 2006 in connection with the regime applicable to dormant bank and building society accounts.

170 Section 106 of the Financial Services and Markets Act 2000.

171 Section 104 of the Financial Services and Markets Act 2000, which makes the provisions of Part VII of the Financial Services and Markets Act 2000 mandatory for an insurance business transfer scheme, was never brought into force in relation to banking business transfer schemes and has now been amended to refer only to insurance business transfer schemes. Therefore the use of the mechanisms of Part VII is optional in relation to a banking business transfer scheme.

order sanctioning the scheme. The application may be made by the English Bank, the transferee or both. Note that a ring-fencing scheme requires consent from the PRA.

If the court sanctions the scheme by order, then certain other provisions of Part VII apply, including section 112A(2), which provides that any right of a person to terminate, modify, acquire or claim an interest or right to treat an interest or right as terminated or modified is not enforceable until after the court has made its order under section 112(1) of the Financial Services and Markets Act 2000 and is then enforceable only to the extent permitted by the order. Section 112(1) gives the court broad powers to make any provision it sees fit to give effect to the transfer and to what is "necessary to secure that the scheme is fully and effectively carried out".

Accordingly, an order under section 112(1) could in theory prejudice a party that has entered into a Credit Support Document with an English Bank. Note that an order can only be made if the court considers that, in all circumstances, it is appropriate to sanction the scheme. However, we do not believe that an English court would make an order under Part VII of the Financial Services and Markets Act 2000 in relation to the sanctioning of a transfer scheme that would (a) prejudice the ability of the Secured Party under a Security Document or the Transferee under an English Transfer Annex to exercise its rights against an English Bank or (b) otherwise materially and adversely affect the rights of the Secured Party or Transferee, as the case may be. Also see Annex 1 of the ISDA Netting Opinion in respect of the potential circumstances in which the designation of an Early Termination Date under the ISDA Master Agreement may not be possible as a result of an order under section 112(1).

2.3 *Banking Act*

Our conclusions in part III and IV of this memorandum are subject to the provisions of the Banking Act, which came into force on 21 February 2009. The Banking Act introduced significant changes to the law relating to English Banks, as described in outline at (a) below and in more detail in the paragraphs that follow.[172]

(a) <u>Key elements of the Banking Act</u>

The Banking Act provides for a 'special resolution regime' applicable to English Banks. Amendments to the Banking Act have widened the Act's scope and in addition to English Building Societies, the Act also applies to certain English Investment Firms and Banking Group Companies.[173]

The special resolution regime in relation to English Banks consists of:

(i) in Part 1 of the Banking Act, a set of five stabilisation options, which are exercised through four stabilisation powers (the **SRR**);

(ii) the Bank Insolvency Procedure (which is a liquidation procedure for English Banks); and

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172 Building societies and credit unions also fall within the scope of the Banking Act. As credit unions do not fall within the scope of this memorandum, we do not discuss them further. English Building Societies are discussed in Annex 3 to this memorandum. Insurance companies may also have fallen within the scope of the Banking Act as a technical matter, due to the way "bank" is defined in sections 2(1) and 91(1). This was not intended and insurance companies are now excluded by virtue of The Banking Act 2009 (Exclusion of Insurers Order) 2010 (SI 2010/35).

173 English Investment Firms, English Building Societies and Banking Group Companies are considered at Annexes 2, 3 and 4 to this memorandum respectively.

(iii) the Bank Administration Procedure (which is an administration procedure for English Banks).[174]

We comment on each of these elements below. The Banking Act also granted the Treasury broad powers to make regulations introducing a special liquidation or administration regime for investment banks, which it did by making the Investment Bank Special Administration Regulations 2011. These Regulations are discussed further in Annex 2 to this memorandum in the context of their application to an English Investment Firm. As outlined above, however, in relation to an English Bank with eligible depositors that is also an investment bank as defined in section 232 of the Banking Act, the Regulations introduce two additional insolvency procedures that may be applied in relation to that English Bank: Special Administration (Bank Insolvency) and Special Administration (Bank Administration). These are discussed at (e) below. The Banking Act also deals with certain other matters, however, these have no relevance to the issues considered in this memorandum.

Part 1 of the Banking Act underwent substantial amendment as part of the implementation in English law of the European Bank Recovery and Resolution Directive[175] (the **BRRD**).

The BRRD seeks to establish a common framework for the orderly resolution of failing credit institutions and investment firms within the European Union (as well as entities within their group if deemed relevant). Member States, including the United Kingdom, had an obligation to transpose and implement the BRRD into national law by 31 December 2014 and to apply the majority[176] of its provisions from 1 January 2015. The BRRD is a 'minimum harmonisation' EU Directive which aims to equip national authorities of the Member States with the relevant resolution tools and powers to restructure failing institutions within its scope. Individual Member States are free to adopt stricter rules and regulations in the context of resolution as long as they remain compliant with the provisions of the BRRD[177]. As part of the implementation of the BRRD, Part 1 of the Banking Act underwent extensive amendment by, *inter alia*, the Bank Recovery and Resolution Order 2014[178] (the **BRR Order**), which came into force on 1 January 2015.

Responsibility for operation of the SRR rests with the four public authorities with primary responsibility for the banking sectors, namely, the Bank of England, the Treasury and the Regulators (together, the **Authorities** and, each, an **Authority**). The PRA's role under the SRR is primarily to decide, together with the Bank of England, whether the general conditions for exercise of a stabilisation power in relation to a failing English Bank have been met.[179] The Regulators also have the right to be consulted on various matters. The stabilisation powers themselves may be exercised by the Bank of England or the Treasury, depending on the relevant circumstances, including the nature of the power being exercised. In the discussion

174 Section 1(2) of the Banking Act.

175 Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014, as published in the Official Journal of the EU on 12 June 2014.

176 Article 130(1) of the BRRD allows for Member States to apply provisions relating to the 'bail-in tool' from 1 January 2016 at the latest.

177 Such rules and regulations must also be in compliance with EU State aid rules – see 'EU Bank Recovery and Resolution Directive (BRRD): Frequently Asked Questions' published by the European Commission on 15 April 2014.

178 SI 2014/3329.

179 Section 7 of the Banking Act.

below, in relation to the exercise of a stabilisation power, references to an "Authority" means either the Bank of England or the Treasury, as appropriate.

We assume in relation to any such exercise that the Authorities have decided that the relevant conditions to the exercise of those powers are satisfied in relation to that English Bank. The general conditions to the exercise of a stabilisation power set out in section 7 of the Banking Act broadly require that the English Bank is failing or is likely to fail and is beyond the reach of less drastic remedial action than application of the SRR. Such action must also be necessary having regard to the public interest in the advancement of the special resolution objectives and one or more of the special resolution objectives would not be met to the same extent by the winding up of the bank (whether under Part 2 or otherwise).[180] Sections 8 and 8ZA specify further specific conditions for a transfer to a private sector purchaser, bridge bank or asset management vehicle and section 9 specifies further specific conditions for a transfer to temporary public ownership.

Sections 5 and 6 of the Banking Act provide for the Treasury to issue a code of practice relating to, *inter alia*, the use by the Authorities of the stabilisation powers, the Bank Insolvency Procedure and the Bank Administration Procedure. The current version of the code of practice was issued in March 2015 (the **Banking Act SRR Code of Practice**). It is not binding on the Authorities but ISDA members may find it helpful to refer to it with regard to the practical operation of the SRR.

Section 10 of the Banking Act provides for the establishment by the Treasury of a panel to advise the Treasury about the effect of the SRR on English Banks and the financial market in which they operate. The panel, known as the Banking Liaison Panel, was established shortly after the Banking Act came into effect and includes representatives from the Authorities as well as the Financial Services Compensation Scheme (the **FSCS**) and various private sector representatives with expertise in the business of banks, financial law and insolvency law.

(b) Stabilisation options and powers

We consider first whether the application of any of the stabilisation powers set out in Part 1 of the Banking Act in relation to an English Bank could affect the validity or enforceability of a Credit Support Document against an English Bank.

(i) *Overview*

The stabilisation options provide for (i) private sector transfer of all or part of the business of the relevant entity; (ii) transfer of all or part of the business of the relevant entity to a bridge bank that is wholly or partially owned by and controlled by the Bank of England; (iii) transfer of all or part of the business of the relevant entity to an asset management vehicle owned (directly or indirectly) by the Bank of England or HM Treasury and controlled by the Bank of England;[181] (iv) writing down certain claims of unsecured creditors of the relevant entity and/or converting certain unsecured debt claims to equity, (the "bail-in option"), which equity could also be subject to any future

180 In relation to the special resolution objectives, see section 4 of the Banking Act.

181 This tool can only be used in conjunction with one of the other stabilisation tools: section 8ZA(2) of the Banking Act.

write-down; and (v) temporary public ownership (nationalisation) of all or part of the relevant entity.[182]

The stabilisation options are achieved through the exercise of one or more of the "stabilisation powers" detailed at section 1(4) of the Banking Act, which are: (i) the share transfer powers (including share transfer instruments under section 15 and share transfer orders under section 16), (ii) the resolution instrument powers (which make provision for bail-in under section 12A), (iii) the property transfer powers (including property transfer instruments under section 33), and (iv) the third country instrument powers (including instruments made under sections 89H and 89I of the Banking Act that recognise the effect of special resolution action taken under the laws of a country outside the EEA).

The Authorities also have certain other wide powers under the Banking Act including the power to modify contractual arrangements in certain circumstances and powers for Treasury to disapply or modify laws (with possible retroactive effect) to enable the stabilisation powers under the Banking Act to be used effectively.[183]

Note that certain 'reverse' and 'onward' transfers are also possible where one of the transfer options has been exercised.

(ii) *Share or property transfer powers*

The "share transfer powers" (as they are referred to in the Banking Act, although the power is broad enough to cover debt securities, warrants and certain other rights, as well as equity shares)[184] grant the Authorities the power to effect the transfer of securities issued by an English Bank and include certain other powers designed to ensure that the exercise of the share transfer power is fully effective. A share transfer by an Authority under the Banking Act would be made by a "share transfer order" or a "share transfer instrument".[185] The exercise of the share transfer powers by an Authority in respect of an English Bank that is a party to the ISDA Master Agreement and Credit Support Document would not affect the rights or obligations of the parties to the ISDA Master Agreement and Credit Support Document, and therefore have no impact on our conclusions in this memorandum.

The exercise by an Authority under the Banking Act of the property transfer powers would be by a "property transfer instrument"[186] or a "property transfer order"[187]. The property transfer powers include certain other powers designed to ensure that an exercise of the property transfer power is fully effective. The exercise of the property transfer powers may provide for the transfer of all property, rights and liabilities of an English Bank or for the

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182 Section 1(3) of the Banking Act.

183 In relation to the power to change law, see section 75 of the Banking Act. We note that section 75(4)(a) states that the Treasury may disapply or modify the effect of a provision of an enactment but not a provision made by or under the Banking Act.

184 Section 14 of the Banking Act.

185 Under section 12A of the Banking Act, the Bank of England may exercise an analogous transfer power in a resolution instrument making provision for securities issued by a specified bank to be transferred to a resolution administrator or another person.

186 Section 33(1) of the Banking Act.

187 Section 45 of the Banking Act, which applies to the temporary public ownership stabilisation option.

transfer of some, but not all, of the property, rights or liabilities of an English Bank.[188] In the latter case, the transfer would be a "partial property transfer".

The Authorities have a broad discretion to decide which property, rights or liabilities are to be transferred. This would include "foreign property", which is defined in section 39 of the Banking Act to be property outside the United Kingdom and rights and liabilities under foreign law. As we are advising only in relation to English law in this memorandum, we must assume that the transfer by an Authority of foreign property by virtue of a property transfer instrument would be effective as to that foreign property.

We note that section 39 of the Banking Act imposes various obligations on the transferor English Bank (it is the "transferor" under the Banking Act notwithstanding the involuntary nature of the transfer) and the transferee to take necessary steps to ensure that the relevant transfer is effective under relevant foreign law,[189] until which time the transferor holds the relevant property or right in trust for the benefit of the transferee or is required to discharge the relevant liability on behalf of the transferee.[190]

The transfer of all of the property, rights and liabilities of an English Bank to a private sector purchaser, a bridge bank or asset management vehicle would necessarily include any ISDA Master Agreement and Credit Support Document entered into by the relevant entity with another market participant, including all Transactions under that ISDA Master Agreement. From the point of view of the other market participant, the identity of its contracting party would change, however the validity and enforceability of the Credit Support Document, as a matter of English law would be unaffected.

We will now consider the application of the partial property transfer power.

(iii) *Summary of conclusions in respect of the partial property transfer power*

For the reasons given below, we are of the view that an Authority may not exercise the partial property transfer power in such a way as to affect the validity or enforceability of a Credit Support Document.

The operation of the Security Document would be disrupted upon the effectiveness of a partial property transfer made in breach of article 5 of the Partial Property Safeguards Order (as defined below), but an administrative remedy would be available to the Secured Party, as described below.

(iv) *Application of the partial property transfer power to an English Bank in respect of the Security Documents and article 5 of the Partial Property Safeguards Order*

The Banking Act 2009 (Restriction of Partial Property Transfers) Order 2009[191] (as amended[192], the **Partial Property Safeguards Order**) provides

188 Section 33(2) of the Banking Act.

189 Section 39(3) of the Banking Act.

190 Section 39(4) of the Banking Act.

191 SI 2009/322.

192 The Partial Property Safeguards Order has been amended by, *inter alia*, the Banking Act 2009 (Restriction of Partial Property Transfers) (Amendment) Order 2009 (SI 2009/1826) and the BRR Order.

various protections for certain arrangements within its scope from the effect of partial property transfers.

Article 5 of the Partial Property Safeguards Order protects security arrangements by providing that a secured liability, the assets securing that liability and the benefit of that security may not be divided as a result of the exercise by an Authority of a partial property transfer power to which the Order applies.[193] The secured liability, security assets and benefit of the security must be transferred together or not at all.[194]

Article 5(2), which applies where an arrangement has been entered into under which one party owes a liability to the other and that liability is secured against property or rights, provides that a partial property transfer may not "transfer the property or rights against which the liability is secured unless that liability and the benefit of the security are also transferred" and article 5(3) states that a partial property transfer may not "transfer the liability unless the benefit of the security is also transferred". Although the drafting of the safeguard provisions of article 5 of the Partial Property Safeguards Order is, in certain technical respects, somewhat deficient, our view is that the intention of article 5 is clearly that, in relation to a partial property transfer within scope, the secured property, the encumbrance of the security interest, and the secured liabilities move together or not at all.

If, notwithstanding article 5, an Authority were to exercise the partial property transfer power such that article 5 was breached in relation to a Security Document, then the Secured Party would have the right to seek a remedy from the Authority under article 12 of the Partial Property Safeguards Order, as discussed in more detail in below.

Section 42A of the Banking Act (Private sector purchaser: reverse property transfer) was inserted into the Banking Act by the Financial Services Act 2012. Article 2 of the Partial Property Safeguards Order has not been updated to clarify that the Partial Property Safeguards Order also applies to Section 42A.[195] We are not aware of any explanation for this state of affairs. We do not see any reason why this provision should not also be covered by the Partial Property Safeguards Order and believe there are strong policy reasons why the Authorities would not wish to exercise such powers to disrupt the operation of a Credit Support Document.

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193 In this context, we note the recent proposals of the European Banking Authority in its Opinion dated 14 August 2015 entitled "Technical advice by the European Banking Authority on classes of arrangements to be protected in a partial property transfer" in connection with Article 76(4) of the BRRD. In relation to security arrangements the EBA specifically proposes that the relevant security assets should be clearly identified, and that, when determining appropriate protection, it should be possible to ensure a reasonable limitation of assets against which the obligations are secured; this may take into account the relation to the value of the secured obligations, which may, however, provide for a certain degree of over-collateralisation.

194 This principle is qualified by article 5(5) of the Partial Property Safeguards Order, however we assume that the circumstances described in article 5(5) do not apply in relation to a Credit Support Document falling within the scope of this memorandum. Article 5(5) would only apply if the arrangement was entered into by the English Bank in contravention of a rule prohibiting such arrangements made by the FCA or the PRA under the Financial Services and Markets Act 2000 or otherwise than in accordance with its Part 4A permission (as such term is defined in the Financial Services and Markets Act 2000).

195 Similarly Article 8 which, subject to a number of exceptions, prohibits the application of a partial property reverse transfer to relevant financial instruments has not been updated.

(v) *Application of the partial property transfer power to an English Bank in respect of the English Transfer Annex and article 3 of the Partial Property Safeguards Order*

Article 3(1) of the Partial Property Safeguards Order provides that a partial property transfer (to which the Order applies) may not provide for the transfer of some, but not all, of the "protected rights and liabilities" between an English Bank and a particular person under a "set-off arrangement, netting arrangement or title transfer financial collateral arrangement".

As noted in the ISDA Netting Opinion, in our view, whilst there are exclusions from the scope of the Partial Property Safeguards Order such as retail deposits, retail liabilities and subordinated debt, assuming that all Transactions are within the scope of Appendix A then all rights and obligations under an ISDA Master Agreement between an English Bank and a party would be "protected rights and liabilities" within the scope of the Partial Property Safeguards Order [196] (except any claims arising under indemnities such as under section 11 of the ISDA Master Agreement) if they are subject to set off or netting under the ISDA Master Agreement.

The English Transfer Annex relies for its effectiveness on the operation of the early termination and close out netting provisions of Section 6 of the ISDA Master Agreement. For this reason, article 3(1) of the Partial Property Safeguards Order would protect the English Transfer Annex from disruption as a result of the exercise by an Authority of the partial property transfer power. An English Transfer Annex may also be a title transfer financial collateral arrangement under the FCA Regulations as discussed in part II of this memorandum.

The discussion of the scope of article 2 of the Partial Property Safeguards Order above applies equally to the English Transfer Annex.

(vi) *Continuity and other powers*

Under the continuity powers conferred by section 64(2) of the Banking Act (including as applied by sections 65(2) and 83(2)(f) of the Banking Act) and section 67(2) of the Banking Act (including as applied by sections 68(2) and 83(2)(f)), the relevant Authority has a number of wide-ranging powers including the ability to cancel or modify a contract between a "residual bank" or "transferred bank" and a third party.[197] The continuity powers could therefore apply after either a property transfer or a share transfer. The purpose of these provisions is to ensure the provision of such services and facilities as are required to enable either the transferred bank to operate

196 In this context, as discussed in the ISDA Netting Opinion, we note the recent proposals of the European Banking Authority in its Opinion dated 14 August 2015 (see footnote 193 above) in connection with Article 76(4) of the BRRD. In relation to set-off arrangements and netting arrangements the EBA specifically proposes that protection should be limited to the categories of liabilities clearly identifiable in the relevant set-off arrangement or netting arrangement and to certain qualifying arrangements and certain liabilities (for example those involving financial contracts as defined in point (100) of Article 2(1) of the BRRD or if the purpose of the arrangement is risk mitigation and it is recognised for risk mitigation under applicable prudential rules), although this should not prevent the protection of those arrangements that are otherwise protected under national insolvency laws.

197 A "residual bank" is a bank all or part of whose business has been transferred in accordance with section 11(2)(b), 12(2), 12ZA(3) or 41A(2) of the Banking Act. A "transferred bank" is a bank all or part of the ownership of which has been transferred in accordance with section 11(2)(a), 12(2)(a) or 13(2) of the Banking Act or in respect of which a mandatory reduction instrument or resolution instrument (or supplemental resolution instrument) has changed the ownership (wholly or partly) of.

effectively or the transferee to operate the transferred business effectively (as applicable).

In relation to a partial property transfer and a collateral arrangement entered into under a Security Document, article 5(4) of the Partial Property Safeguards Order provides that a partial property transfer (within the scope of the Order, as to which see above) may not include provision under the continuity powers which "terminates or modifies the arrangement if the effect of that provision is to provide that the liability is no longer secured against the property or right." Article 5(4) would therefore protect a Security Document between an English Bank and a third party from disruption as a result of the exercise by an Authority of a continuity power in connection with a partial property transfer.

In relation to an English Transfer Annex, article 3(2) of the Partial Property Safeguards Order confirms that a partial property transfer within the scope of the Partial Property Safeguards Order may not include provision under the continuity powers that terminates or modifies any protected rights or liabilities between an English Bank and the party to the set-off arrangement, netting arrangement or title transfer financial collateral arrangement. Article 3(2) would therefore protect an English Transfer Annex between an English Bank and a third party from being disrupted by the exercise of a continuity power where a partial property transfer has occurred.

No such explicit protection exists in the case of a full property transfer or a transfer of all or part of the ownership of the English Bank pursuant to powers granted under the Banking Act. However, as discussed above, the continuity powers exist to ensure that the transferee or the transferred bank (as applicable) is provided with such services and facilities required to enable it to operate effectively[198] and we consider it unlikely that such powers would be used in such a way as to disrupt the operation of a Credit Support Document in the context of a transfer of ownership or full property transfer.

In addition to the continuity powers, there are other powers in the Banking Act that could at least potentially be used to modify or affect contractual rights. Section 75 gives power to the Treasury to change the law, including with retrospective effect (other than the Banking Act), for the purpose of enabling the powers under Part 1 of the Banking Act to be used effectively. Sections 23 and 40 also provide that share transfer instruments or orders or property transfer instruments may include incidental, consequential or transitional provision the scope of which are not clear but which may potentially have an impact on contractual rights.

(vii) *Remedies for breach of the Partial Property Safeguards Order*

The nature of a counterparty's remedy for breach of the Partial Property Safeguards Order in relation to a Credit Support Document between the counterparty and an English Bank depends on the nature of the breach. The remedies are set out in Part 3 of the Partial Property Safeguards Order.

198 Sections 63(2) and 66(2) of the Banking Act.

Partial property transfer – breach of article 5 of the Partial Property Safeguards Order

If an Authority makes a partial property transfer that has one or more of the effects described in paragraphs (2), (2A) and (3) of article 5 of the Partial Property Safeguards Order, then this would constitute a breach of article 5.

A partial property transfer in breach of article 5 would (absent some other available grounds for invalidating it) be effective when made. A person adversely affected by the breach (the **Claimant**), however, would have the right to apply to the relevant Authority for a remedy of the breach under article 12 of the Partial Property Safeguards Order.

The procedure for obtaining a remedy under article 12 is as follows:

(A) The Claimant must give notice of the breach to the Authority in accordance with article 12(4) of the Partial Property Safeguards Order within 60 days of the day on which the partial property transfer took effect.

(B) The Authority then has up to 60 days to consider whether it agrees that a breach has occurred. [199] In a particularly complicated case, the Authority has the right to extend its time for consideration by an additional 60 days.[200]

(C) If the Authority agrees that a breach has occurred, then it is required to transfer the relevant property, rights and/or liabilities (or, if this is not practicable, equivalent property, rights and/or liabilities)[201] to the transferee or the transferor (as these terms are defined in the Banking Act in relation to a property transfer), as appropriate, in order to remedy the breach.[202]

(D) If the Authority does not agree that a breach has occurred, then it must give its reasons to the Claimant.[203] This decision would be subject to judicial review.

The Secured Party would, by complying with the procedure in article 12, be able to obtain a remedy for a disruption of the operation of the Security Document as a result of the exercise by an Authority of the partial property transfer power in breach of article 5 of the Partial Property Safeguards Order.

Therefore, on the basis of the Partial Property Safeguards Order and subject to the analysis above, we conclude that the exercise by an Authority of a partial property transfer power in relation to an English Bank would either not affect

199 Article 12(5) of the Partial Property Safeguards Order.

200 Article 12(8) of the Partial Property Safeguards Order.

201 Article 12(9) of the Partial Property Safeguards Order. The word "equivalent" in article 12(9) is not defined, so the Authority would probably have some discretion to determine what constitutes an equivalent item of property, right or liability for this purpose.

202 Article 12(6) of the Partial Property Safeguards Order.

203 Article 12(7) of the Partial Property Safeguards Order.

the validity and enforceability of a Security Document, or if made in breach of article 5, would be subject to an administrative remedy.

Partial property transfer – breach of article 3(1) of the Partial Property Safeguards Order

Articles 11(1)(a) and 11(2) of the Partial Property Safeguards Order provide that, where a partial property transfer has been made in contravention of article 3 (unless the contravention relates to the exercise of continuity powers in which case article 10 applies), then that partial property transfer will not affect the exercise of that right to set off or net.

As a result of article 11, it will never be necessary for a party to an ISDA Master Agreement to seek an administrative remedy under article 12 of the Partial Property Safeguards Order in relation to a contravention of article 3.

Therefore, on the basis of the Partial Property Safeguards Order and subject to the analysis above, we conclude that the exercise by an Authority of a partial property transfer power in relation to an English Bank would not affect the validity and enforceability of an English Transfer Annex against the English Bank.

Continuity power – breach of article 5(4) or 3(2) of the Partial Property Safeguards Order

In the event of the exercise of a continuity power by an Authority in connection with a partial property transfer in breach of:

(A) article 5(4) of the Partial Property Safeguards Order in relation to a Security Document; or

(B) article 3(2) in relation to an English Transfer Annex,

article 10 of the Partial Property Safeguards Order would invalidate the partial property transfer in so far as it relates to the exercise of the continuity power in breach of the Partial Property Safeguards Order.

(viii) *Bail-in option*

The fourth stabilisation option, the bail-in option, is exercised through the making of one or more resolution instruments. A resolution instrument made under section 12A of the Banking Act may make "special bail-in provision" with respect to a specified English Bank.[204]

Pursuant to section 48B(1), "special bail-in provision" means any of the following (or a combination of the following):

(A) provision cancelling a liability owed by the bank;

[204] A property transfer instrument under section 11(2), 12(2), 12ZA(3) or 41A(2) or an associated supplemental property transfer instrument, may also make special bail-in provision with respect to the bank (see section 44B of the Banking Act).

(B) provision modifying, or changing the form of, a liability owed by the bank; and

(C) provision that a contract under which the bank has a liability is to have effect as if a specified right had been exercised under it.

When the Bank of England exercises the resolution instrument powers it must do so in accordance with section 12AA of the Banking Act.[205]

In relation to the Security Documents, the concern is that special bail-in provision could apply so as to reduce the value of, or eliminate, the Obligations of the English Bank with the effect that the security interest is undermined. However, in this regard, section 48B(4)(b) of the Banking Act states that a power to make special bail-in provision may not be exercised so as to affect any "excluded liability". An "excluded liability" for these purposes includes "any liability so far as it is secured"[206]. Secured for this purpose means secured against property or rights, or otherwise covered by collateral arrangements.[207] The implications of these provisions for the Security Documents are discussed below.

In relation to the English Transfer Annex, the concern is that special bail-in provision could apply so as to reduce or eliminate the amount owed by the English Bank under Transactions under the ISDA Master Agreement (excluding the Transaction constituted by the English Transfer Annex) with the effect that the ability of the other contracting party to net the Value of the Credit Support Balance against liabilities due to it under such Transactions as part of the calculation of the net amount payable under Section 6(e) of the ISDA Master Agreement, pursuant to Paragraph 6 of the English Transfer Annex, is commensurately reduced or eliminated. However, in this respect, article 4 (Set-off and netting) of the Banking Act 2009 (Restriction of Special Bail-in Provision, etc.) Order 2014[208] (the **Bail-in Safeguards Order**) prohibits special bail-in provision from being made in respect of a "protected liability". A "protected liability" is a liability of the English Bank owed to a particular person which such person or the bank is entitled to set-off or net under a set-off arrangement, netting arrangement or title transfer collateral arrangement between the relevant person and the bank and that has not been converted into a net debt, claim or obligation. Article 4(4)(b) states that a liability is treated as if converted into a net debt, claim or obligation if the amount due in relation to the liability is reduced by reference to any sums which the debtor would be able to 'set off' against the liability in the event that the debtor decided to exercise set off or netting rights.

For these purposes, "set-off arrangements" means arrangements under which two or more debts, claims or obligations can be set off against each other; "netting arrangements" means arrangements under which a number of claims or obligations can be converted into a net claim or obligation and includes, in particular, "close-out" netting arrangements, under which actual or theoretical debts are calculated during the course of a contract for the purpose of

205 Section 12A(2B) of the Banking Act.

206 Section 48B(7A) and (8)(b) of the Banking Act.

207 Section 48D(1) of the Banking Act.

208 SI 2014/3350.

enabling them to be set off against each other or to be converted into a net debt; and "title transfer collateral arrangements" means arrangements under which Person 1 transfers assets to Person 2 on terms providing for Person 2 to transfer assets if specified obligations are discharged.[209]

As discussed in the ISDA Netting Opinion, we are of the view that the ISDA Master Agreement would be a "netting arrangement" or "set-off arrangement" for these purposes. We are also of the view that the ISDA Master Agreement, together with the English Transfer Annex, would constitute a "title transfer collateral arrangement" for these purposes. However, a liability is not a protected liability for the purposes of the Bail-in Safeguards Order if it is of a type listed in article 4(3) of the Order. For present purposes this includes unsecured liabilities in relation to any instrument or contract which, at the date on which it was issued or made, had a maturity period of 12 months or more and is not a derivative, financial contract or qualifying master agreement [210] and unsecured liabilities owed to another member of the same group as the relevant bank which are not owed in relation to derivatives, financial contracts or qualifying master agreements.[211]

In the Order "derivative" means a derivative as defined in Article 2(5) of Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4th July 2012 on OTC derivatives, central counterparties and trade repositories (EMIR) and "financial contract" includes: a contract for the purchase, sale, transfer or loan of a transferable security; a repurchase transaction or reverse repurchase transaction on any transferable security; certain commodities contracts of a financial nature; and futures contracts. A "qualifying master agreement" means a master agreement in so far as it relates to a derivative, financial contract or contract for the sale, purchase or delivery of the currency of the United Kingdom or another country, territory or monetary union.[212] Undertakings are in the same group if they are group undertakings in respect of each other as defined in section 1161(5) of the Companies Act 2006.[213]

To the extent that the Transactions (other than the Transaction constituted by the English Transfer Annex) under the ISDA Master Agreement are "derivatives" or "financial contracts" as defined in the Bail-in Safeguards Order or the ISDA Master Agreement including all Transactions (other than the Transaction constituted by the English Transfer Annex) thereunder is otherwise a "qualifying master agreement", the operation of the close-out netting provisions of the ISDA Master Agreement, including Paragraph 6 of the English Transfer Annex, would be effectively protected and these exclusions from the scope of the protection of the Bail-in Safeguards Order will not apply. Please note that, in our view, these exclusions would be capable of applying to liabilities that arise under an agreement that would otherwise constitute a qualifying master agreement "in so far as" those liabilities relate to Transactions that are not derivatives, financial contracts or contracts for the sale, purchase or delivery of a currency. Most of the

209 Section 48P(2) of the Banking Act.

210 Article 4(3)(d) of the Bail-in Safeguards Order.

211 Article 4(3)(e) of the Bail-in Safeguards Order.

212 Article 5 of the Bail-in Safeguards Order.

213 Article 4(5) of the Bail-in Safeguards Order.

Transactions described in Appendix A will satisfy the definitions of either "derivative" or "financial contracts" and, in so far as the ISDA Master Agreement relates to such Transactions or transactions for the sale, purchase or delivery of a currency, the ISDA Master Agreement will be a "qualifying master agreement". It is conceivable, however, that certain Transactions described in Appendix A may fall outside the scope of these definitions. In any event, we do not believe that these exclusions in the Bail-in Safeguards Order would apply in the context of an ISDA Master Agreement collateralised with an English Transfer Annex given the meaning of 'secured' in the legislation, as discussed below.

As noted above, the power to make special bail-in provision may not be exercised so as to affect any excluded liability, which includes any liability so far as it is secured. The definition of ‘secured’ for this purpose extends to liabilities covered by title transfer collateral arrangements.[214] In respect of an ISDA Master Agreement collateralised with the English Transfer Annex, the collateral is applied as an Unpaid Amount as part of close-out and the Bail-in Safeguards Order would, in any event, subject to the discussion above, prohibit the bail-in of liabilities in respect of Transactions prior to the conversion into a net debt (including the application of the Unpaid Amount in respect of Collateral transferred by the English Bank). The position is different with respect to the Security Documents where the Transactions would first be converted into a net debt (which is, subject to the discussion above, required by the Bail-in Safeguards Order) and the value of the Collateral then applied to that net debt. It is only portion of the net debt that exceeds the value of the Collateral that would be subject to bail in.

Furthermore, the exclusions from the scope of the Bail-in Safeguards Order discussed above apply only to unsecured liabilities. The definition of ‘secured’ in the context of the Bail-in Safeguards Order should be ascribed the meaning referred to above. Therefore, where the ISDA Master Agreement is collateralised by the English Bank pursuant to either the Security Documents or the English Transfer Annex, such exclusions would not be relevant notwithstanding the existence of one or more Transactions that do not fall within the definition of "derivative" or "financial contract" or otherwise cause the ISDA Master Agreement to fail to be a "qualifying master agreement" in so far as it relates to such Transactions. In any event, as mentioned above, a liability may not be subject to bail-in so far as it is secured and, as the collateralisation under the Credit Support Documents is performed on a net basis, we would argue that the liabilities under the ISDA Master Agreement would need to be converted into a net debt in accordance with the close-out netting provisions, against which the Collateral the subject of the security interest under the Security Documents would be applied or which would include the Unpaid Amount in respect of the English Transfer Annex (as applicable), before any net debt that exceeds the value of the Collateral could be considered for bail-in. For these reasons, the presence of a Credit Support Document would, in our view, ensure that the close-out netting provisions of the ISDA Master Agreement operate in accordance with their terms in the context of bail-in of the Collateral Provider.

214 Section 48D of the Banking Act.

Article 6(7) and article 6(8) of the Bail-in Safeguards Order provide that if special bail-in provision has been made in contravention of the Bail-in Safeguards Order, the remedies are for the Bank of England:

(A) to require the relevant bank or bridge bank (as applicable) to issue securities to the affected person or to transfer securities issued by the relevant bank or bridge bank (as applicable) to the affected person, in either case, which the Bank of England estimates to have a value equal to the relevant sum; or

(B) to require the relevant bank or bridge bank (as applicable) to transfer the relevant sum to the affected person.

For these purposes "relevant sum" means such sum as the Bank of England considers necessary to put the relevant person in the position the person would have been in had the contravention not occurred.

On the basis of the Bail-in Safeguards Order and subject to the above discussion, we conclude that the exercise by the Authorities of the resolution instrument powers in relation to an English Bank would not affect the validity and enforceability of the Credit Support Documents against the English Bank.

Please note that although the section 48B(4)(b) of the Banking Act and the Bail-in Safeguards Order act to preserve the effectiveness of the Credit Support Documents, any net sum owed by the English Bank following the enforcement of the security interest or the operation of the close-out netting provisions of the ISDA Master Agreement together with Paragraph 6 of the English Transfer Annex (as appropriate) would itself be at risk of being reduced or eliminated by the making of special bail-in provision. Also note that the Bail-in Safeguards Order does not prevent special bail-in provision from being made to convert a protected liability into a net debt, claim or obligation.[215]

In addition, in this context, we note that, under section 6B of Banking Act (which is technically a pre-resolution tool and not part of the SRR), the Bank of England must, where the section applies[216] (which includes where the Bank of England or Treasury has decided to exercise a stabilisation power under the SRR in respect of the English Bank in circumstances where section 12AA does not apply), make an instrument (a "mandatory reduction instrument") containing the mandatory reduction provision. The "mandatory reduction provision" is essentially provision for the write-down or conversion of capital instruments and must be made in accordance with the principles and procedures specified in sections 6B and 6C. The capital instruments subject to these provisions are Common Equity Tier 1 instruments, Additional Tier 1 instruments and Tier 2 instruments.[217] Accordingly, the Transactions under the ISDA Master Agreement would not be directly affected by these provisions.

215 Article 4(6) of the Bail-in Safeguards Order.

216 See section 6A of the Banking Act for the circumstances in which section 6B applies.

217 These terms are defined in section 3 of the Banking Act.

(ix) *Overrides and stays*

Under section 48Z(6) of the Banking Act (which applies, *inter alia*, where a contract or other agreement is entered into by an English Bank and the substantive obligations provided for in the contract or agreement continue to be performed), the following are to be disregarded in determining whether a default event provision (which includes a provision of an agreement that has the effect that, if a specified event occurs or situation arises, the agreement or any rights or duties thereunder are terminated or a sum becomes payable or delivery becomes due or other right accrues) applies:

(A) a crisis prevention measure or crisis management measure taken in relation to the bank or a member of the same group (as defined at section 474 of the Companies Act 2006) as the bank; and

(B) the occurrence of any event directly linked to the application of such a measure.

The terms "crisis management measure" and "crisis prevention measure" are defined at section 48Z(1) of the Banking Act by reference to the BRRD and include certain action taken under the Banking Act and the BRRD. In addition a mandatory reduction instrument, a share transfer instrument, a property transfer instrument or a resolution instrument (each a **Part 1 instrument**) or a share transfer order may, in circumstances where section 48Z(6) does not apply, provide that the Part 1 instrument or share transfer order should be disregarded in determining whether a default event provision applies.[218] See also the multi-branch discussion at Part 2 of this Annex 1 below in respect of certain cross-border scenarios where the restriction on termination could also be engaged.

In the present context, the effect of the section is that the right of the Secured Party to enforce the security interest in the Collateral pursuant to the Security Documents or, in relation to the English Transfer Annex (as discussed in the ISDA Netting Opinion), the right of the Transferee to terminate and close-out Transactions in accordance with the ISDA Master Agreement (including Paragraph 6 of the English Transfer Annex), would be ineffective in certain circumstances including where such rights arise as a result of the exercise of a stabilisation power in relation to the English Bank. However, such rights based on the existence or occurrence of other events or circumstances, should not be affected. Therefore we do not consider that such power has an impact on the conclusions in this memorandum.

Note that the definition of a 'default event provision' at section 48Z would also be wide enough to include Section 2(a)(iii) of the ISDA Master Agreement such that a party to an ISDA Master Agreement with an English Bank may not rely on Section 2(a)(iii) to withhold its performance in circumstances where that Section is rendered applicable by a crisis prevention measure or crisis management measure taken in relation to the bank or member of its group.

218 Section 48Z(7) of the Banking Act.

As discussed in Annex 1 of the ISDA Netting Opinion, under section 70A of the Banking Act, the Bank of England may suspend obligations to make a payment or delivery under a contract where one of the parties to the contract is an English Bank subject to a stabilisation power. This power is exercisable by way of provision in a share transfer instrument, property transfer instrument, resolution instrument or third-country instrument. Any such period of suspension must end no later than midnight at the end of the first business day following the day on which the instrument providing for the suspension is published.[219] Section 70A(3)(c) clarifies that all the obligations of the parties to the relevant contract will be suspended. Any payments or deliveries 'due' under the ISDA Master Agreement (including the relevant Credit Support Document) during the stay period, while not being made by either party, will instead become due at the end of such period (subject to the terms of the ISDA Master Agreement and relevant Credit Support Document).[220] Similarly, pursuant to section 70C of the Banking Act, the Bank of England may suspend the termination rights (which includes a right to close out, set-off or net obligations or any similar provision that extinguishes an obligation of a party to the contract and a provision that prevents an obligation from arising under the contract) of any party to a contract with a bank under resolution assuming that all the obligations under the contract to make payments or deliveries or provide collateral continue to be performed. Again, any such suspension must end no later than midnight at the end of the first business day following the day on which the relevant instrument providing for the suspension is published. Furthermore, pursuant to section 70B of the Banking Act, the Bank of England may suspend the rights of a secured creditor of a bank subject to a stabilisation power to enforce any security interest the creditor has in relation to the assets of the bank.[221] Any such suspension must also end no later than midnight at the end of the first business day following the day on which the relevant instrument is published.

Noting that the restrictions under sections 70A, 70B and 70C of the Banking Act will not prejudice a party in seeking to enforce its rights against the English Bank under the ISDA Master Agreement and the relevant Credit Support Document upon expiration of the stay, we do not consider that such powers have an impact on our conclusions herein regarding the enforceability of the Credit Support Documents.

(c) Bank Insolvency Procedure

The Bank Insolvency Procedure is an additional procedure for winding up or liquidating an English Bank (if the English Bank has depositors who are eligible depositors). It is based on the provisions for the liquidation of an English Company, as described in this memorandum, but adapted to further the purposes of the Banking Act and, in particular, to transfer the accounts of eligible depositors to another financial institution or to facilitate rapid payments to such depositors under the FSCS.[222]

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219 Section 70A(3) of the Banking Act.

220 Section 70A(4) of the Banking Act.

221 Assuming such secured creditor is not an 'excluded person' (see section 70D of the Banking Act) and the security interest is in assets of the bank that have been pledged or provided to the excluded person as collateral or as cover for margin.

222 Section 103(6) of the Banking Act sets out a table showing how the relevant provisions of the Insolvency Act 1986 have been modified for the purpose of the Bank Insolvency Procedure.

The detailed operation of the Bank Insolvency Procedure is subject to the Bank Insolvency (England and Wales) Rules 2009 (the **Bank Insolvency Rules**),[223] which are comparable to the provisions of the Insolvency Rules 1986 that apply to the winding up of a company. Rule 72 of the Bank Insolvency Rules sets out an insolvency set-off provision that is, for present purposes, substantially the same as Rule 4.90 of the Insolvency Rules 1986. There are some differences between the two provisions, but these have no bearing on our conclusions in this memorandum.

The Bank Insolvency Procedure is not mandatory. For example, an ordinary winding up or liquidation of an English Bank under the Insolvency Act 1986 could still occur. It is likely, however, that the Bank Insolvency Procedure would be used where the Authorities decide that putting the failed English Bank straight into liquidation is the best or only viable course to take.

The Bank Insolvency Procedure may be initiated by any of the Secretary of State, the Bank of England or the PRA making an application to the court for a bank insolvency order under section 95 of the Banking Act. In each case certain conditions and grounds must be satisfied, including (i) in the case of the Bank of England, that the PRA has informed the Bank of England it is satisfied that Condition 1 in section 7 of the Banking Act is met; and (ii) in the case of the PRA, that the Bank of England has informed the PRA that it is satisfied that Condition 2 in section 7 of the Banking Act is met and the Bank of England has consented to the application.

There are various technical differences between the winding up of an English Company under the Insolvency Act 1986 and the Bank Insolvency Procedure, but these have no material effect on our conclusions in relation to the issues discussed in this memorandum.

(d) Bank Administration Procedure

The Bank Administration Procedure is an additional procedure for the administration of a failing English Bank. It is based on the provisions for the administration of an English Company, as described in this memorandum, but adapted to further the purposes of the Banking Act.[224] In particular, the Bank Administration Procedure is intended to be used in relation to a failing English Bank where there has been a partial transfer of business from the failing English Bank to a private sector purchaser or bridge bank. The bank administrator appointed by the court would be empowered and required to ensure that the non-transferred part of the English Bank (referred to in the Banking Act as the "residual bank") provides services or facilities required to enable a private sector purchaser or bridge bank that has acquired the transferred business to operate effectively.

The Bank Administration Procedure would be initiated by the Bank of England making an application to the court for a bank administration order under section 142 of the Banking Act. The Bank Administration Procedure is not mandatory. For example, an ordinary administration under the Insolvency Act 1986 could still occur. It is highly likely, however, that where a transfer of part of the business of a failed bank has occurred, the Bank Administration Procedure would be commenced by the Bank of England in relation to the residual bank.

223 SI 2009/356, which came into effect on 25 February 2009.

224 Section 145(6) of the Banking Act sets out a table showing how the relevant provisions of the Insolvency Act 1986 have been modified for the purpose of the Bank Administration Procedure.

The detailed operation of the Bank Administration Procedure is subject to the Bank Administration (England and Wales) Rules 2009 (the **Bank Administration Rules**),[225] which are comparable to the provisions of the Insolvency Rules 1986 that apply to the administration of a company. Rule 61 of the Bank Administration Rules applies various provisions of the Insolvency Rules 1986 to the conduct of a Bank Administration Procedure, including Rule 2.85.

The moratorium on enforcement under paragraph 43 and 44 of Schedule B1 to the Insolvency Act 1986 also applies to the Bank Administration Procedure under section 145 of the Banking Act subject, in relation to paragraph 43, to (i) in the case of bank administration following transfer to a bridge bank, the requirement for Bank of England approval in addition to administrator consent until the Bank of England has given an 'Objective 1 Achievement Notice'; and (ii) the court must also consider the objectives of the Bank Administration Procedure when giving any permissions. Objective 1 is to ensure the supply to the private sector purchaser or bridge bank of such services and facilities as are required to enable it, in the opinion of the Bank of England, to operate effectively.

There are various technical differences between the administration of an English Company under the Insolvency Act 1986 and the Bank Administration Procedure, but these have no material effect on our conclusions in relation to the issues discussed in this memorandum.

(e) Special Administration (Bank Insolvency) and Special Administration (Bank Administration)

As noted above, where an English Bank is also an investment bank as defined in section 232 of the Banking Act, there are additional insolvency procedures that may be applied to it, namely, Special Administration (Bank Insolvency) and Special Administration (Bank Administration) under the Investment Bank Special Administration Regulations 2011.

Note that if the English Bank, as a matter of fact, has no eligible depositors, then Special Administration (Bank Insolvency) would not be available and instead either Investment Bank Special Administration or Special Administration (Bank Administration) would apply.[226] See Annex 2 in respect of Investment Bank Special Administration.

The purpose of these additional procedures is to act as an alternative to the Bank Insolvency Procedure or, as the case may be, the Bank Administration Procedure in relation to an English Bank that is also an investment bank. In other words, in circumstances where a failing English Bank would otherwise have been put into the Bank Insolvency Procedure, it could, if it is also an investment bank, be put instead into Special Administration (Bank Insolvency).

Similarly, in circumstances where an English Bank that is a residual bank under the Banking Act would otherwise have been put into the Bank Administration Procedure, it could, if it is also an investment bank, be put instead into Special Administration (Bank Administration).

225 SI 2009/357, which came into effect on 25 February 2009.

226 Regulation 3(4) of the Investment Bank Special Administration Regulations 2011.

Regulation 3(3) makes it clear that an investment bank that is an English Bank with eligible depositors may not be put into Investment Bank Special Administration, but may be put into Special Administration (Bank Insolvency) or Special Administration (Bank Administration), as appropriate. Schedule 1 to the Regulations governs Special Administration (Bank Insolvency). Schedule 2 governs Special Administration (Bank Administration).

The detailed operation of each procedure is governed by the Investment Bank Special Administration (England and Wales) Rules 2011 [227] (the **Investment Bank Administration Rules**). The Investment Bank Administration Rules are comparable to the provisions of the Insolvency Rules 1986 that apply to the administration of a company. Part 2, Chapter 2 of the Rules governs the procedure for applying for a special administration (bank insolvency) order. Part 2, Chapter 3 of the Rules governs the procedure for applying for a special administration (bank administration) order. The remaining Rules apply in relation to both procedures (and also to Investment Bank Special Administration, as discussed in Annex 2).

Neither procedure is mandatory. Which procedure is commenced in relation to a failing English Bank, if either, will be determined by the Authorities, subject to the approval of the court, and will depend on a variety of circumstances that cannot be predicted *ex ante*. For present purposes, though, the issue is whether the commencement of either procedure in relation to an English Bank would materially and adversely affect the enforceability of the Credit Support Documents against the English Bank.

Rule 164 of the Investment Bank Administration Rules sets out an insolvency set-off provision that, for present purposes, is substantially the same as Rule 4.90 and Rule 2.85 of the Insolvency Rules 1986. It applies in relation to each procedure, as amended by Rule 165 in the case of Special Administration (Bank Insolvency) and Special Administration (Bank Administration) if all or part of a creditor's claim against the English Bank is in respect of protected deposits. While there are some differences between Rule 164 (as amended by Rule 165, if applicable) and Rule 4.90 and Rule 2.85 of the Insolvency Rules 1986, these differences have no bearing on our conclusions in this memorandum.

The moratorium on enforcement under paragraph 43 and 44 of Schedule B1 to the Insolvency Act also applies to Special Administration (Bank Insolvency) and Special Administration (Bank Administration) under regulation 15 and Schedule 1 paragraph 5 and Schedule 2 paragraph 6 of the Investment Bank Special Administration Regulations 2011. In the case of Special Administration (Bank Administration) the application of paragraph 43 is subject to (i) in the case of Special Administration (Bank Administration) following transfer to a bridge bank, the requirement for Bank of England approval in addition to administrator consent until the Bank of England has given an 'Objective A Achievement Notice'; and (ii) the court must also consider Objective A and the special administration objectives when giving any permissions. Objective A is to provide support for a private sector purchaser or bridge bank.

Although there are various technical differences between, on the one hand, the administration of an English Company under the Insolvency Act 1986 and, on the other hand, Special Administration (Bank Insolvency) or Special Administration

227 SI 2011/1301, which came into effect on 30 June 2011.

(Bank Administration), as the case may be, subject to the analysis above these differences have no material effect on our conclusions in relation to the issues discussed in this memorandum.

2.4 *The Winding Up Directive*

As noted in our answer to question 20, the EC Insolvency Regulation does not apply to an English Bank. Instead, an English Bank would be subject to an alternative European cross-border insolvency law regime applicable to credit institutions under the Winding Up Directive, which was implemented in the United Kingdom by the Winding Up Regulations.[228]

See part IV of the ISDA Netting Opinion and also the multibranch discussion below in respect of the impact of this regime on the multibranch analysis. In addition, see paragraph 2.1 of Annex 1 and Appendix D of the ISDA Netting Opinion in relation to the application of the Winding Up Directive and the Winding Up Regulations to an English Bank that is party to a New York law governed ISDA Master Agreement. Annex 1 to the ISDA Netting Opinion discusses the derogation at regulation 34 of the Winding Up Regulations. Regulation 34 and, indeed, regulation 28 (in relation to set-off – discussed at Appendix D of the ISDA Netting Opinion) may also be relevant when considering the enforceability of the New York Annex. Note that there are further derogations in the Winding Up Regulations not discussed in the ISDA Netting Opinion that may also apply when considering the enforceability of the Credit Support Documents in the event of the insolvency or resolution of an English Bank. These include regulations 26 (Third parties' rights in rem), 29 (Regulated markets), 30 (Detrimental acts pursuant to the law of an EEA State), 31 (Protection of third party purchasers) and 33 (Lex rei sitae).

We discuss the position under English law only in this memorandum.

Regulation 26 is analogous to Article 5 of the EC Insolvency Regulation. It is therefore relevant where the location of the Collateral under the Security Documents is outside of England and states that a relevant reorganisation or a relevant winding up shall not affect the rights in rem of creditors or third parties in respect of assets situated within the territory of an EEA State at the relevant time. Where the requirements of regulation 26 are met it would therefore lead to the disapplication of a stay on enforcement of the security interest imposed in the context of an administration or CVA of an English Bank.[229]

As noted in our answer to question 20, the Cross Border Insolvency Regulations would also not apply to an English Bank.

2.5 *The FCA Regulations*

The protections afforded to financial collateral arrangements by the FCA Regulations upon insolvency apply also in the context of the Bank Insolvency Procedure[230], the Bank Administration Procedure[231], Special Administration (Bank Insolvency)[232], Special

228 SI 2004/1045.

229 Unlike the EC Insolvency Regulation, neither the Winding Up Regulations nor the Winding Up Directive set out specific rules for the determination of the location of the relevant assets for this purpose.

230 The Bank Insolvency Procedure is a "winding-up proceeding" as defined in the FCA Regulations. See also the Banking Act 2009 (Parts 2 and 3 Consequential Amendments) Order 2009 (SI 2009/317), article 3.

231 See the Banking Act 2009 (Parts 2 and 3 Consequential Amendments) Order 2009 (SI 2009/317), article 3.

232 See the Investment Bank Special Administration Regulations 2011, Schedule 1, paragraph 3. In our view this provision applies Schedule 6 of the Regulations to Special Administration (Bank Insolvency).

Administration (Bank Administration)[233] and Investment Bank Special Administration[234], subject to the discussion below.

In relation to the scope of application of the FCA Regulations, the secondary legislation cited in support of the proposition above clarifies that a reference in the FCA Regulations to winding up or administration (as applicable) under the Insolvency Act 1986 should be read as including a reference to the relevant insolvency proceeding. The application of regulation 12, for instance, which states that a close-out netting provision takes effect in accordance with its terms notwithstanding the winding up or administration of the collateral-provider or collateral-taker, is therefore seemingly not in doubt.

In relation to other provisions of the FCA Regulations, however, that operate by disapplying certain onerous provisions of English insolvency law, an argument could be made that by not expressly disapplying such provisions *as applied* by another insolvency proceeding (where such provisions as originally enacted do not apply to such insolvency proceeding), such provisions have not been effectively disapplied in that context by the FCA Regulations. On a purposive interpretation of the FCA Regulations, we would construe them as disapplying such provisions of insolvency law in respect of financial collateral arrangements whether those provisions apply directly to an insolvency proceeding or indirectly by subsequent extension but we note the contrary view is arguable. This is a general point in respect of the interpretation of the FCA Regulations and applies equally to other insolvency proceedings considered in this memorandum, which apply provisions of the Insolvency Act 1986 or other enactments, perhaps with amendment, or indeed apply those provisions as applied by another insolvency proceeding.

In contrast, where legislation provides that an insolvency regime applicable to companies generally applies to a particular Counterparty with modification (rather than creating an independent insolvency proceeding that applies provisions relating to an existing insolvency proceeding), in our view, the issue described above does not arise. Those provisions that are disapplied by the FCA Regulations (if they applied to the Counterparty to begin with) apply directly to such insolvency proceeding to which the Counterparty is subject.

In any event, in respect of the Bank Insolvency Procedure and the Bank Administration Procedure, paragraph 3(4) of the Banking Act 2009 (Parts 2 and 3 Consequential Amendments) Order 2009 clarifies that references in the FCA Regulations to the provisions of the Insolvency Act 1986 shall be read to include those provisions as applied and modified by sections 103 and 145 of the Banking Act and that references to the provisions of the Insolvency Rules 1986 shall be read to include those provisions as applied and modified by rules made under section 411(1A), in relation to the Bank Insolvency Procedure, or section 411(1B), in relation to the Bank Administration Procedure, of the Insolvency Act 1986. In relation to regulation 14 of the FCA Regulations, which relates to the application of Rules 4.91 and 2.86 of the Insolvency Rules 1986, Rule 74 of the Bank Insolvency Rules and Rule 61 of the Bank Administration Rules apply Rules 4.91 and 2.86 of the Insolvency Rules 1986, respectively, to the Bank Insolvency Procedure and the Bank Administration Procedure including for the purposes of the relevant mandatory set-off rules.

Schedule 6 of the Investment Bank Special Administration Regulations 2011 contains similar language in respect of Investment Bank Special Administration (discussed further at Annex 2). We are of the view that the effect of paragraph 3 of Schedule 1 and paragraphs 4 and 5 of Schedule 2 of the Regulations is to apply Schedule 6 to Special Administration (Bank

233 See the Investment Bank Special Administration Regulations 2011, Schedule 2, paragraphs 4 and 5. In our view these provisions apply Schedule 6 of the Regulations to Special Administration (Bank Administration).

234 See the Investment Bank Special Administration Regulations 2011, regulation 27 and Schedule 6.

Insolvency) and Special Administration (Bank Administration). However, the currency conversion provision for the purposes of mandatory set-off set out at Rule 166 of the Investment Bank Administration Rules is a standalone provision and does not apply either Rules 4.91 or 2.86 of the Insolvency Rules 1986. It could therefore be argued that regulation 14 of the FCA Regulations has no application to Investment Bank Special Administration, Special Administration (Bank Insolvency) or Special Administration (Bank Administration). The relevant provision in Schedule 6 of the Investment Bank Special Administration Regulations 2011 is subtly different from the equivalent provision in the Banking Act 2009 (Parts 2 and 3 Consequential Amendments) Order 2009 and provides that references to "the provisions of the Insolvency Rules 1986 […] include the provisions of insolvency rules made under section 411 of the Insolvency Act as applied by regulation 15(6)."[235] We would argue that this should be interpreted to mean that a reference to Rule 4.91 or Rule 2.86 of the Insolvency Rules 1986 in regulation 14 of the FCA Regulations includes reference to the analogous provision of the Investment Bank Administration Rules but this is not free from doubt.

In relation to regulation 12 of the FCA Regulations, note that regulation 12(5) provides that nothing in regulation 12 prevents the Bank of England imposing a restriction on the effect of a close-out netting provision in the exercise of its powers under Part 1 of the Banking Act. Similarly, regulation 18A provides that nothing in regulation 16 (Right of use under a security financial collateral arrangement) and regulation 17 (Appropriation of financial collateral under a security financial collateral arrangement) prevents the Bank of England imposing a restriction on the enforcement of financial collateral arrangements or on the effect of a security financial collateral arrangement, close-out netting provision or set-off arrangement (as defined in Article 2.1(99) of the BRRD) in the exercise of its powers under Part 1 of the Banking Act.[236]

3 SECURITY DOCUMENTS

On the basis of the assumptions and subject to the qualifications in this memorandum as modified and supplemented by this Annex 1 and subject to the analysis set out in this Annex 1, we are of the view that the analysis in part III.3 of this memorandum of issues relating to the enforceability of the Security Documents against a Security Collateral Provider would apply in circumstances where the Security Collateral Provider is an English Bank.

4. ENGLISH TRANSFER ANNEX

On the basis of the assumptions and subject to the qualifications in this memorandum as modified and supplemented by this Annex 1 and subject to the analysis set out in this Annex 1, we are of the view that the analysis in part IV.3 of this memorandum of issues relating to the enforceability of the English Transfer Annex would apply to an English Bank in the event that insolvency proceedings are commenced in England in respect of the English Bank.

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235 The Investment Bank Special Administration Regulations 2011, Schedule 6, paragraph 1(2)(i). Regulation 15(6) applies section 411 of the Insolvency Act 1986 to Investment Bank Special Administration. Paragraph 5 of Schedule 1 to the Investment Bank Special Administration Regulations 2011 applies section 411 as applied by regulation 15(6) to Special Administration (Bank Insolvency) and paragraph 6(4) of Schedule 3 to the Investment Bank Special Administration Regulations 2011 applies section 411 as applied by regulation 15(6) to Special Administration (Bank Administration).

236 The BRRD amended the Collateral Directive to state that the Collateral Directive shall be without prejudice to the BRRD (see Article 9a).

PART 2 –BANKS ACTING ON A MULTIBRANCH BASIS

Certain English Banks are multibranch entities. The issues that may arise when dealing with an English Bank that is a multibranch entity are beyond the scope of this memorandum but for a discussion of certain issues that may arise when an English Bank is transacting through an overseas branch, see part IV of the ISDA Netting Opinion. Many of the same issues would apply similarly to a Credit Support Document (particularly if the Collateral is being provided by a foreign branch of the English Bank).

In Part 2 of this Annex 1, we briefly discuss the enforceability of the Credit Support Documents in the event that insolvency proceedings are commenced in England in respect of an English Branch which is providing Collateral under a Credit Support Document. As with an English Bank, certain issues may also arise as a result of the other branches of the Foreign Entity or the jurisdiction of incorporation which are beyond the scope of this memorandum. For a discussion of certain of such issues, please see part IV of the ISDA Netting Opinion.

As discussed in part IV of the ISDA Netting Opinion, whether or not the English Branch can enter into insolvency proceedings in England will depend on the Winding Up Regulations, implementing the Winding Up Directive.

If the English Branch is part of an EEA credit institution, under the Winding Up Regulations, no winding up proceedings or reorganisation measures (including resolution action) in respect of the English Branch can be undertaken in the United Kingdom except in the circumstances permitted by the Winding Up Regulations.[237]

Under section 221 of the Insolvency Act 1986 the English courts would have jurisdiction to wind up an English Branch of a non EEA credit institution. Please see part IV of the ISDA Netting Opinion for a detailed discussion of how section 221 of the Insolvency Act 1986 would apply, including the discretion of the court in determining whether or not to take jurisdiction.

If an English Branch is not part of an EEA credit institution and is subject to winding up proceedings in England then:

(a) in respect of the Security Documents, our conclusions in respect of winding up proceedings set out in questions 16 and 18 would apply *mutatis mutandis*; and

(b) in respect of the English Transfer Annex, our conclusions in respect of winding up proceedings set out in questions 25 to 27 would also apply *mutatis mutandis* for the reasons given therein and subject to the discussion in part IV of the ISDA Netting Opinion in respect of the enforceability of close-out netting under the ISDA Master Agreement in such circumstances.

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237 Note that the basic rule of the Winding Up Directive is that the home member state of an EEA credit institution will have exclusive jurisdiction to open insolvency proceedings in relation to the EEA credit institution and the insolvency law of that member state will govern the effect of those insolvency proceedings throughout the European Union. This is discussed in more detail in the ISDA Netting Opinion.

However, there are certain derogations which includes a derogation for certain rights *in re*. The Winding Up Directive provides that the adoption of reorganisation measures of the opening of winding-up proceedings shall not affect the rights *in re* of creditors or third parties in respect of tangible or intangible, movable or immovable assets (including both specific assets and collections of indefinite assets as a whole which change from time to time) belonging to the affected credit institution which are situated within the territory of another Member State at the time of the adoption of such measures or the opening of such proceedings. Similar derogations exist in the Winding Up Directive in relation to the enforcement of proprietary rights in certain instruments, rights of third party purchasers, rights of set-off and rights under netting agreements (as mentioned above in relation to the Winding Up Regulations).

It is generally not considered possible to have an administration, administrative receivership or CVA in relation to a foreign company that is a credit institution unless section 426(5) of the Insolvency Act 1986 applies.[238] Since foreign companies are liable to be wound up under section 221, a foreign company can also be subject to a scheme of arrangement assuming there is sufficient connection with England (see part IV of the ISDA Netting Opinion).

When facing an English Branch of a non EEA credit institution, consideration should also be given to the application of the Banking Act. As discussed in more detail at part IV of the ISDA Netting Opinion, the powers under Part 1 of the Banking Act may, subject to certain modifications, be exercised by the Authorities in respect of a third country institution (as defined in section 89H(7) of the Banking Act (a **Third Country Institution**), being broadly an entity the head office of which is established in a country outside the EU that would, if it were established within the EU, be a credit institution or an investment be firm as defined in the BRRD), in circumstances where a Third Country Institution (or third-country parent undertaking (again, as defined in section 89H(7) of the Banking Act)) is subject to resolution action in a state other than an EEA state (a **Third Country Resolution Action**).[239] The Winding Up Regulations provide, at regulation 3(7A), that a 'stabilisation instrument' (which includes a third country instrument made under section 89H of the Banking Act) shall not be made in respect of an EEA credit institution.

Section 89I(3) of the Banking Act makes it clear that the stabilisation powers are only available in respect of the Third Country Institution to the extent that they would be available in respect of a similar entity in the United Kingdom. Accordingly, please refer to the analysis in Part 1 of this Annex 1 for a discussion of how these powers may be exercised in respect of an English Bank. However, it should be noted that, where a third country instrument made under section 89H recognises a Third Country Resolution Action (or part of it), such Third Country Resolution Action (or part of it) is expressed in the Banking Act to have the same effect in the UK as it would have produced had it been made with due authority under the law of the relevant part of the UK.[240] Note that to qualify as a Third Country Resolution Action, the Banking Act requires that the anticipated results of the third country action must be broadly comparable to the results which could have been anticipated from the exercise of a stabilisation option in relation to an entity in the UK corresponding to the relevant third country institution or parent undertaking and the objectives of the action must also be broadly comparable to those in section 4 of the Banking Act.[241] However, the nature and effect of the recognised Third Country Resolution Action is ultimately a question for the relevant foreign law.

Article 2(4B) of the Partial Property Safeguards Order clarifies that the protections afforded by the Partial Property Safeguards Order will apply where the Bank of England has made a third country instrument in accordance with section 89H or any further third country instruments made under section 89I(4)(b) which, in either case, makes provision which would otherwise be made in a property transfer order and constitutes a partial property transfer.

Section 48Z of the Banking Act also applies such that the Third Country Resolution Action recognised by the Bank of England pursuant to section 89H(2) of the Banking Act or the exercise of a stabilisation power in respect of a Third Country Institution or member of its group (as defined in section 474 of the Companies Act 2006) pursuant to section 89I(3) of the Banking Act alone shall not

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238 See definition of 'company' in (i) paragraph 111(1A) of Schedule B1 of the Insolvency Act 1986 in respect of administration; (ii) section 28(1) of the Insolvency Act 1986 in respect of administrative receivership; and (iii) section 1(4) of the Insolvency Act 1986 in respect of CVAs.

239 See Chapter 6 (Third-country Resolution Actions) of the Banking Act. See also Part VII Pending Developments of this memorandum in respect of Article 96 of the BRRD which is not yet implemented in the UK which requires the UK to provide the Authorities with the necessary powers to resolve a UK branch of a Third Country Institution that is not subject to Third County Resolution Action, or where the Authorities have refused to recognise or enforce Third Country Resolution Action.

240 Section 89I(2) of the Banking Act.

241 See definition of "third country resolution action" in section 89H(7) of the Banking Act.

permit a counterparty of the Third Country Institution to terminate and close-out the ISDA Master Agreement or to enforce security in respect of it.

ANNEX 2

ENGLISH INVESTMENT FIRM

In this Annex 2, we set out our views regarding the enforceability of the Credit Support Documents in the event that resolution action or insolvency proceedings are commenced in England in respect of an English Investment Firm.

The resolution regime (if any) and the insolvency proceedings that are available in respect of an English Investment Firm depend on its particular status.

For all English Investment Firms the applicable procedures include each type of insolvency proceeding that may be commenced in England in relation to an English Company as set out in part III.1(4) of the ISDA Netting Opinion.

If the English Investment Firm is an 'investment firm' as defined in section 258A of the Banking Act (being broadly an investment firm subject to the €730,000 initial capital requirement under the EU Capital Requirements Regulation but subject to some exclusions) then the SRR in Part 1 of the Banking Act and the Bank Administration Procedure are also applicable.

If the English Investment Firm is an 'investment bank' as defined in section 232 of the Banking Act (which requires that it holds client assets and has at least one of a specified list of authorisations under the Financial Services and Markets Act 2000 relating to investments), then Investment Bank Special Administration is applicable.

If the English Investment Firm is both an 'investment firm' under section 258A of the Banking Act and an 'investment bank' under section 232 of the Banking Act then, in addition to each of the procedures above, Special Administration (Bank Administration) is also applicable.

1. Conclusion

On the basis of the assumptions and subject to the qualifications in this memorandum as modified and supplemented by this Annex 2, we are of the view that our conclusions in this memorandum in relation to an English Company would also apply to an English Investment Firm, including in the event of its becoming subject to: (a) one of the forms of insolvency proceeding under the Insolvency Act 1986; (b) the Bank Administration Procedure; (c) Investment Bank Special Administration; (d) Special Administration (Bank Administration); or (e) the SRR.

2. Analysis

The conclusions in paragraph 1 of this Annex are subject to the discussion below.

2.1 *Insolvency proceedings under the Insolvency Act 1986 or scheme of arrangement under the Companies Act 2006*

The insolvency proceedings applicable to an English Company may also apply to an English Investment Firm, subject to the qualification that the Regulators have certain powers to initiate and to intervene in insolvency proceedings in relation to an English Investment Firm. Neither the existence nor the possibility of the exercise of any of these powers would have a material and adverse effect on our conclusions in this memorandum as they would apply to an English Investment Firm.

2.2 *Banking Act*

The SRR and the Bank Administration Procedure apply to systemically important English Investment Firms. Under section 258A of the Banking Act, an English Investment Firm will be within the scope of the regime (an **English Banking Act Investment Firm**) if it is an investment firm which is (or, but for the exercise of a stabilisation power, would be) an investment firm for the purposes of the Capital Requirements Regulation[242], but excluding:

(a) any institution which is also:

(i) an English Bank;

(ii) an English Building Society; or

(iii) a credit union within the meaning of section 31 of the Credit Unions Act 1979; and

(b) any institution within the scope of Article 29 of the Capital Requirements Directive.[243]

The reference to the Capital Requirements Directive excludes from scope any investment firm that is not subject to an initial capital requirement of EUR 730,000.

Sections 89A and 159A of the Banking Act apply Part 1 (Special Resolution Regime) and Part 3 (Bank Administration) of the Banking Act (respectively) to English Banking Act Investment Firms as such provisions apply to English Banks subject to certain modifications none of which are relevant to our conclusions as expressed in Annex 1 in respect of an English Bank. Accordingly, see Annex 1 to this memorandum for a detailed discussion of how Parts 1 and 3 of the Banking Act apply to English Banks.

2.3 *Investment Bank Special Administration Regulations 2011*

(a) Investment Bank Special Administration

Sections 233 and 234 of the Banking Act granted the Treasury broad power to make regulations modifying the law of insolvency as it applies to investment banks and to establish procedures for the liquidation or administration of an investment bank with certain broad objectives set out in section 233(3) of the Banking Act, including identifying, protecting and facilitating the return of client assets. The Treasury exercised this power by making the Investment Bank Special Administration Regulations 2011[244], which came into effect on 8 February 2011.

Under section 232 of the Banking Act, an "investment bank" is a UK institution that holds client assets (including client money) and has permission under Part 4A of the Financial Services and Markets Act 2000 to carry on at least one of the following regulated activities: (a) safeguarding and administering investments; (b) dealing in investments as principal; and (c) dealing in investments as agent.[245]

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242 Regulation (EU) 575/2013 of the European Parliament and of the Council.

243 Directive 2013/36/EU of the European Parliament and of the Council. This exclusion is set out in the Banking Act 2009 (Exclusion of Investment Firms of a Specified Description) Order 2014 (SI 2014/1832).

244 SI 2011/245.

245 This is a broad definition, arguably broader than the market understanding of the term "investment bank". There will, however, be English Investment Firms that fall outside its scope.

In relation to an English Investment Firm that is an investment bank, the Regulations introduce an additional form of insolvency proceeding called investment bank special administration and referred to in the Regulations as "special administration", which we refer to as "Investment Bank Special Administration" to avoid confusion with the other forms of special administration introduced by the Regulations. Note that Investment Bank Special Administration could also apply to an investment bank that is an English Bank that has no depositors that are eligible for compensation under the FSCS as discussed in Annex 1.

Investment Bank Special Administration is based on the existing provisions for the administration of an English Company, as described in this memorandum, but adapted to further the purposes set out in section 233 of the Banking Act, which include, in addition to the usual goals of collective insolvency procedures, (a) identifying, protecting and facilitating the return of client assets, (b) minimising the disruption of business and markets and (c) maximising the efficiency and effectiveness of the financial services industry in the United Kingdom.

The special administrator has greater powers than an administrator in relation to an English Company, but also additional statutory objectives, which are: (1) to ensure the return of client assets as soon as is reasonably practicable; (2) to ensure timely engagement with market infrastructure bodies and the Authorities including facilitating the operation of the relevant default rules and resolving unsettled trades or settlement instructions; and (3) either to rescue the investment bank as a going concern or to wind it up in the best interest of the creditors.[246]

The detailed operation of Investment Bank Special Administration is subject to the Investment Bank Special Administration (England and Wales) Rules 2011.[247] The Rules are comparable to the provisions of the Insolvency Rules 1986 that apply to the administration of a company. Rule 164 sets out an insolvency set-off provision that, for present purposes, is substantially the same as Rule 2.85 of the Insolvency Rules 1986. There are some differences between the two provisions, but these have no bearing on our conclusions in this memorandum.

The moratorium on enforcement under paragraph 43 and 44 of Schedule B1 to the Insolvency Act also applies to Investment Bank Special Administration under regulation 15 of the Investment Bank Special Administration Regulations 2011.

Investment Bank Special Administration could be initiated by any of various interested parties specified in regulation 5, including the investment bank itself, the directors, one or more creditors and various others, including the Secretary of State, the FCA or, if the investment bank is a PRA-authorised person, the PRA, making an application to the court for a special administration order on one of the grounds specified in regulation 6, namely, that (i) the investment bank is, or is likely to become, unable to pay its debts, (ii) it would be fair to put the investment bank into Investment Bank Special Administration or (iii) it is expedient in the public interest to put the investment bank into Investment Bank Special Administration.

Where the FCA is not the person seeking the order, it must be notified of the application and has various rights to consent to the application and give directions to

246 Regulation 10.

247 SI 2011/1301, which came into effect on 30 June 2011.

the administrator. The PRA also has such rights if the relevant investment bank is a PRA-authorised person. In contrast to the administration of an English Company, there are no circumstances in which a special administrator may be appointed out of court.[248]

Investment Bank Special Administration is not mandatory, and an English Investment Firm that is an investment bank could still be made subject to administration under the Insolvency Act 1986. It is highly likely, however, that Investment Bank Special Administration will be commenced in relation to a failing investment bank in preference to ordinary administration.[249]

There are various technical differences between the administration of an English Company under the Insolvency Act 1986 and Investment Bank Special Administration, but these have no material effect on our conclusion in relation to the issues discussed in this memorandum.

(b) Special Administration (Bank Administration)

Article 10 of the Financial Services Act 2012 (Consequential Amendments and Transitional Provisions) (No 3) Order 2013[250] amended Schedule 2 of the Investment Bank Special Administration Regulations 2011 to extend Special Administration (Bank Administration) to investment banks that are not deposit-taking banks. As Special Administration (Bank Administration) applies where part of the business of the investment bank is sold to a commercial purchaser in accordance with section 11 of the Banking Act or transferred to a bridge bank in accordance with section 12, an English Investment Firm would seem capable of being made subject to Special Administration (Bank Administration) only if it is also an investment firm under section 258A of the Banking Act (and therefore within the scope of the SRR).[251] See Annex 1 to this memorandum for a discussion of the operation of Special Administration (Bank Administration) in relation to English Banks.

2.4 *Winding Up Regulations*

As discussed in our answer to question 20, the EC Insolvency Regulation does not apply to an English Investment Firm.

English Investment Firms that are 'investment firms' as defined in section 258A of the Banking Act are subject to the Winding Up Regulations. It is not possible for the UK to wind up or resolve an EEA investment firm with its head office in an EEA state other than the UK.

In respect of English Investment Firms within the scope of the Winding Up Regulations, we therefore assume the head office is in England.

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248 Regulation 8.

249 On 31 October 2011 the Financial Services Authority announced that MF Global UK Limited had entered Investment Bank Special Administration, becoming the first investment bank to do so. Since then a number of further entities have entered into Investment Bank Special Administration including Pritchard Stockbrokers Limited, WorldSpreads Limited and City Equities Limited.

250 SI 2013/1765.

251 Despite some ambiguity in relation to the application of Special Administration (Bank Administration) to investment banks in the Regulations themselves (the change to Schedule 2 sits uneasily with article 9, which states that Schedule 2 applies where the investment bank is a deposit-taking bank), this application was confirmed by the Treasury in its consultation paper on Secondary legislation for Non-Bank resolution regimes published on 26 September 2013.

In respect of English Investment Firms within the scope of the Winding Up Regulations, see paragraph 2.1 of Annex 1 and Appendix D of the ISDA Netting Opinion in respect of the treatment of New York law governed ISDA Master Agreements. See also paragraph 2.4 of Part 1 of Annex 1 hereto for additional discussion of the application of the various derogations in the Winding Up Regulations to the Credit Support Documents.

2.5 *The FCA Regulations*

See paragraph 2.5 of Part 1 of Annex 1 hereto in relation to the application of the FCA Regulations in the context of the Bank Administration Procedure, Special Administration (Bank Administration) and Investment Bank Special Administration and the interaction between the SRR and the FCA Regulations.

3 SECURITY DOCUMENTS

On the basis of the assumptions and subject to the qualifications in this memorandum as modified and supplemented by this Annex 2 and subject to the analysis set out in this Annex 2, we are of the view that the analysis in part III.3 of this memorandum of issues relating to the enforceability of the Security Documents against a Security Collateral Provider would apply in circumstances where the Security Collateral Provider is an English Investment Firm.

4 ENGLISH TRANSFER ANNEX

On the basis of the assumptions and subject to the qualifications in this memorandum as modified and supplemented by this Annex 2 and subject to the analysis set out in this Annex 2, we are of the view that the analysis in part IV.3 of this memorandum of issues relating to the enforceability of the English Transfer Annex would apply in the event that insolvency proceedings are commenced in England in respect of the English Investment Firm.

ANNEX 3

ENGLISH BUILDING SOCIETY

In this Annex 3, we set out our views regarding the enforceability of the Credit Support Documents in the event that resolution action or insolvency proceedings are commenced in England in respect of an English Building Society.

1. Conclusion

On the basis of the assumptions and subject to the qualifications in this memorandum as modified and supplemented by this Annex 3, we are of the view that our conclusions in this memorandum in relation to an English Company would also apply to an English Building Society, including in the event of it becoming subject to: (a) one of the forms of insolvency proceeding under the Building Societies Act 1986; (b) the Building Society Insolvency Procedure under Part 2 of the Banking Act; (c) the Building Society Special Administration Procedure under Part 3 of the Banking Act; or (d) the SRR.

2. Analysis

The conclusion in paragraph 1 of this Annex 3 is subject to the discussion below.

In paragraph 2.1 of this Annex 3, we discuss the enforceability of the Credit Support Documents against an English Building Society in the event of its winding up under the Building Societies Act 1986, in the now relatively unlikely event that it is not subject to the SRR, the Building Society Special Administration Procedure, or the Building Society Insolvency Procedure.

In paragraph 2.2 of this Annex 3, we discuss the enforceability of the Credit Support Documents against an English Building Society in the event that it becomes subject to the SRR (which may include, as a consequence, it becoming subject to the Building Society Special Administration Procedure) or the Building Society Insolvency Procedure.

2.1 *Insolvency proceedings under the Building Societies Act 1986*

In this paragraph 2.1, we assume that the English Building Society has not been made subject to the SRR (which may include, as a consequence, it becoming subject to the Building Society Special Administration Procedure) or the Building Society Insolvency Procedure, but has become subject to one of the forms of insolvency proceeding set out in Part X and in Schedules 15 and 15A to the Building Societies Act 1986.[252]

Those provisions apply parts of the Insolvency Act 1986 to building societies with various modifications, principally to reflect the legislative framework for building societies, which differs in various respects from that applicable to companies, and to reflect the mutual nature of an English Building Society (that is, the fact that it is owned by its members, who are also its principal depositors and borrowers). These provisions allow for the possibility of a voluntary winding up, winding up by the court or administration of an English Building Society or for its entering into a CVA with its creditors.[253]

252 Part X of the Building Societies Act 1986 also includes provisions relating to mergers and the transfer of the business of a building society which are outside the scope of this memorandum.

253 Section 87 of the Building Societies Act 1986 contemplates dissolution by consent of its members, but this would have no impact on existing contractual obligations of the English Building Society and would therefore occur only on a solvent basis, after agreement between the English Building Society and the other party to terminate the relevant contract on an agreed basis or following completion of one of the insolvency procedures mentioned in this Annex 3. Section 91 of the Building Societies Act

As is the case with English Banks and English Investment Firms (see Annex 1 and Annex 2), the FCA and, if the society is a PRA-authorised person, the PRA have certain powers to initiate and to intervene in insolvency proceedings in relation to an English Building Society. Neither the existence nor the possibility of the exercise of any of these powers would have a material and adverse effect on our conclusions this memorandum as they would apply to a Building Society.[254]

Paragraph 58 of Schedule 15 to the Building Societies Act 1986 provides that rules may be made under section 411 of the Insolvency Act 1986 for the purpose of giving effect, in relation to building societies, to the provisions of the parts of the Insolvency Act 1986 made applicable to building societies by Part X and Schedules 15 and 15A of the Building Societies Act 1986.

In other words, the Insolvency Rules 1986, which apply to companies, do not apply to building societies. Instead, similar but appropriately adapted rules were to have been brought into effect in relation to building societies. Unfortunately, no such rules have ever been prepared or published.[255] Therefore, there is no statutory equivalent for building societies of the company insolvency set-off provision in Rule 4.90 of the Insolvency Rules 1986, which applies in the winding up of an English Company.

In relation to administration, an English Building Society would be subject, with appropriate modifications, to the administration regime that applied to companies prior to the coming into force of the changes to the administration regime made by the Enterprise Act 2002.[256] That older regime does not provide for the administrator to make distributions to creditors and therefore there would, in any event, have been no statutory set off provision comparable to Rule 2.85 of the Insolvency Rules 1986 in any insolvency rules applicable to an English Building Society, had they ever been adopted. The older regime did, however, provide for a statutory moratorium at sections 10 and 11 of the Insolvency Act 1986, which for present purposes was substantially the same as that which now applies pursuant to paragraphs 43 and 44 of Schedule B1.

We do not know why the insolvency rules for English Building Societies have not yet been introduced, but there is no reason to believe that the failure to introduce insolvency rules for English Building Societies arises because of a concern of principle regarding the application of insolvency set off in the event of the insolvency of an English Building Society. Accordingly, the disapplication of insolvency set-off to building societies since the Building Societies Act 1986 should, in our view, be considered merely a legislative lacuna arising due to a failure of administration, rather than as the result of a deliberate policy choice. The policy reasons in favour of insolvency set off in relation to English Building Societies are as strong as they are in relation to individuals or companies.[257] The inclusion of statutory

1986 gives the court the power to declare the dissolution of a building society void on an application by, among others, "any ... person appearing to the Court to be interested", which would certainly include a creditor of the building society. A building society that is in the course of dissolution by consent may be wound up by the court under section 86(2). In our view, therefore, the power of the members to dissolve a building society by consent has no material impact on the conclusions in this memorandum.

254 For example see Sections 89 and 90D of the Building Societies Act 1986.

255 We are not aware of any official explanation for this state of affairs having ever been given, despite our having made enquiry of the relevant authorities on numerous occasions over the years following the coming into force of the Building Societies Act 1986.

256 Section 249 Enterprise Act 2002.

257 The Financial Markets Law Committee published a paper in December 2007 entitled "Building Society and Friendly Society Set-off: Proposal for a Mandatory Insolvency Set-Off Rule applicable to Building Societies and Incorporated Friendly Societies", which deals with these issues in some detail. The paper may be accessed at: http://www.fmlc.org/uploads/2/6/5/8/26584807/118.pdf (accessed on 30 December 2015).

insolvency set-off provisions in the legislation for the Building Society Insolvency Procedure and the Building Society Special Administration Procedure under the Banking Act, as discussed in part 2.2 of this Annex 3, strengthens this conclusion.

It should be noted that where a creditor petitions for the insolvency of an English Building Society, section 90D of the Building Societies Act 1986 requires they give the PRA and the Bank of England seven days' notice of the petition to enable them to consider whether to apply for a building society insolvency order or exercise a stabilisation power. The Banking Act SRR Code of Practice provides that when considering whether to use an SRR tool in respect of a failing building society, the authorities will have regard to the benefits of ensuring that if a building society is to enter liquidation proceedings, it is done under the Building Society Insolvency Procedure. In particular, they will take into account that the BSI Rules do include a statutory set-off provision.

An English Building Society was previously prohibited from granting a floating charge under section 9B of the Building Societies Act 1986. A limited exception was created under the Financial Assistance Order 2010 under the Banking Act.[258] Section 9B has now been generally repealed and an English Building Society is permitted to grant floating charges.

However, administrative receivership is not available outside the scope of the Financial Assistance Order because Schedules 15 and 15A to the Building Societies Act 1986 continue to provide that, in the provisions of the Insolvency Act 1986, references to administrative receivers are omitted. Administrative receivership is available in respect of 'relevant building societies' under the Financial Assistance Order which is a building society which receives financial assistance from a qualifying institution; has entered into an agreement with a qualifying institution under which it may receive financial assistance from that institution or has received an offer of such an agreement or of financial assistance from a qualifying institution. The term "qualifying institution" is defined to include only public sector lenders, namely, the Treasury, the Bank of England, another central bank of a member state of the European Economic Area and the European Central Bank. The Financial Assistance Order amends section 90A(c) of the Building Societies Act 1986 so that the provisions of the Insolvency Act 1986 relating to administrative receivership, appropriately modified, would apply to an English Building Society that has granted a floating charge over the whole of its undertaking to a qualifying institution.

Part VI of the Insolvency Act 1986 (Miscellaneous Provisions applying to companies which are insolvent or in liquidation) applies to building societies by virtue of section 90, section 90A, Schedule 15, Part I paragraph 1, and Schedule 15A, Part I paragraph 1, of the Building Societies Act 1986. Consequently, our analysis in the body of this memorandum in respect of sections 238, 239, 244 and 245 of the Insolvency Act 1986 remains unchanged where the Counterparty is an English Building Society.[259]

It is possible that a Building Society could be made subject to a scheme of arrangement under Part 26 of the Companies Act 2006 for the reasons given in Annex 9 in relation to Chartered

258 SI 2010/1188.

259 Section 423 of the Insolvency Act 1986, which relates to transactions at an undervalue which prejudice other creditors, is in Part XVI of the Insolvency Act 1986. However, notwithstanding the fact that it appears in the Insolvency Act 1986, section 423 may be invoked even where there are no insolvency proceedings and is the latest incarnation of a very old rule against fraudulent conveyances. It is available to any creditor of any person (not limited to companies) who has been defrauded by entry into a transaction at any undervalue by that person with a third person and may therefore be applicable to building societies in any event, particularly outside of an insolvency.

Corporations. The same arguments as apply in relation to a Chartered Corporation would arguably also apply in relation to a Building Society.[260]

2.2 *Banking Act*

The conclusions in this memorandum are subject to the provisions of the Banking Act to the extent that they apply to English Building Societies. Section 84 of the Banking Act applies the SRR for banks set out in Part 1 of the Banking Act to English Building Societies, subject to various modifications. This is discussed in (a) below.

Section 130 of the Banking Act empowers the Treasury by order to apply Part 2 of the Banking Act (Bank Insolvency), with appropriate modifications, to English Building Societies. This is discussed in (b) below. Section 158 of the Banking Act provides a comparable power to the Treasury to apply Part 3 of the Banking Act (Bank Administration), with appropriate modifications, to English Building Societies. This is discussed in (c) below.

We note that section 232 of the Banking Act does not expressly carve out an English Building Society from the definition of institution that can qualify as an investment bank. Therefore, if an English Building Society met the relevant conditions relating to safeguarding or dealing in investments and also holding client assets, then it would technically be an investment bank. If that were the case, the additional procedures under the Investment Bank Special Administration Regulations 2011 discussed at Annex 2 in relation to an English Investment Firm would potentially be applicable. However, we discuss the more likely position below – i.e. where the English Building Society is subject to the Banking Act regime that has been specifically designed for such entities (including taking account of the mutual status of an English Building Society). In addition, we are not aware of English Building Societies that would commonly engage in activities that would place them within the scope of the definition of an investment bank.

(a) Special resolution regime applicable to English Building Societies

The SRR applicable to an English Building Society by virtue of section 84 of the Banking Act is based on the SRR applicable to an English Bank described in Annex 1 (including the application of the Partial Property Safeguards Order).[261] There are a number of modifications to the SRR in respect of an English Building Society due to its mutual status.

In respect of the bail-in option, section 84A of the Banking Act provides that a resolution instrument with respect to an English Building Society may, *inter alia*:

(i) convert the building society into a company incorporated under the Companies Act 2006; or

(ii) transfer all the property, rights and liabilities of the building society to a company incorporated under the Companies Act 2006,[262] and

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260 The key to the argument is the breadth of the word "company" in section 895(2)(b) of the Companies Act 2006, as discussed in Annex 9. It is clear that this is intended to be broader than an English Company. An English Building Society is a body corporate and the fact that it is a mutual would not exclude it from the scope of the word "company" in that context.

261 Section 84 provides that the SRR applies to building societies as it applies to banks subject to the modifications in sections 84 to 84D.

262 In respect of a conversion, the successor company may be wholly owned by a company as long as that parent company is wholly owned by the Bank of England; a resolution administrator or a person nominated by the Bank of England. Similarly, a transferee company must immediately before the transfer be wholly owned by the Bank of England; a resolution administrator; a person nominated by the Bank of England; or a company wholly owned by one of such specified entities.

cancel shares and membership rights of the building society and convert shares into deposits of the successor company. The effect of this is to demutualise the building society.

Upon such a resolution instrument being made, section 84D of the Banking Act provides that the bail-in option would apply in respect of such successor or its parent and applies various provisions of the Banking Act as they would apply to a bank subject to various modifications. Note that it is expected that the successor company would be authorised as a bank.[263] It is not entirely clear from section 84D how the other stabilisation options would be exercised in respect of the successor company but in any event it is clear property transfers are possible as section 41A is expressly referred to in section 84D.

For the purposes of this memorandum, the bail-in option may be exercised in respect of a successor company in substantially the same manner as in respect of an English Bank, including subject to the relevant protections contained in the Bail-in Safeguards Order.[264] The exercise of the bail-in option in respect of an English Bank is discussed in part 2.3(b)(viii) of Annex 1 to this memorandum

There are various other differences between the regime applicable to English Banks and that applicable to English Building Societies (for example the method of transferring to temporary public ownership is different), but these have no material effect on our conclusions in relation to the issues discussed in this memorandum.[265]

(b) Building Society Insolvency Procedure

The Treasury exercised its power under section 130 of the Banking Act by making the Building Societies (Insolvency and Special Administration) Order 2009 (the **BSISA Order**),[266]. The BSISA Order inserts section 90C into the Building Societies Act 1986 which applies Part 2 (Bank Insolvency) and Part 3 (Bank Administration) to building societies.

The procedure in Part 2 of the Banking Act as applied to an English Building Society, with appropriate modifications, is called "building society insolvency" (the **Building Society Insolvency Procedure**).

The detailed operation of the Building Society Insolvency Procedure is subject to the Building Society Insolvency (England and Wales) Rules 2010 (the **BSI Rules**),[267] which are comparable to the provisions of the Insolvency Rules 1986 that apply to the winding up of an English Company. Rule 73 of the BSI Rules sets out an insolvency set-off provision that is, for present purposes, substantially the same as Rule 4.90 of the Insolvency Rules 1986. There are some differences between the two provisions, but these have no bearing on our conclusions in this memorandum.

263 See explanatory note to the Building Societies (Bail-in) Order 2014/3344.

264 See section 84D(3) of the Banking Act which provides that statutory instruments made under sections listed in the table apply. Section 48P of the Banking Act is listed in the relevant table in section 84D..

265 On Saturday, 28 March 2009 a Scottish building society, Dunfermline Building Society, went into the special resolution regime under Part 1 of the Banking Act. It was the first bank or building society to be made subject to the regime after the Banking Act came into effect on 21 February 2009. See Bank of England press release dated 30 March 2009 on Dunfermline Building Society, available at: http://www.bankofengland.co.uk/archive/Documents/historicpubs/news/2009/030.pdf (accessed 30 December 2015).

266 SI 2009/805.

267 SI 2010/2581.

As in the case of the Bank Insolvency Procedure, the Building Society Insolvency Procedure is based on the existing provisions for the liquidation of an English Company, as described in this memorandum, but adapted to further the purposes of the Banking Act and, in particular, eligible claimants having their accounts transferred to another financial institution or receiving payments under the FSCS.

The Building Society Insolvency Procedure is not mandatory. One of the other insolvency proceedings described in paragraph 2.1 of this Annex 3 could be applied to an English Building Society (although see the discussion of mandatory set-off above). It is likely, however, that the Building Society Insolvency Procedure would be used where the Authorities have applied the SRR to an English Building Society and where the Authorities have decided that putting the failed English Building Society straight into liquidation is the best or only viable course to take.

The Building Society Insolvency Procedure may be initiated by any of the Secretary of State, the Bank of England or the PRA making an application to the court for a building society insolvency order under section 95 of the Banking Act as modified by section 90C of the Building Societies Act 1986. The Secretary of State can apply if the Building Society has eligible claimants under the FSCS and the winding up is in the public interest. The Bank of England can apply if (i) the PRA has informed the Bank of England it is satisfied that Condition 1 in section 7 is met and (ii) the Bank of England is also satisfied that certain conditions are met. Finally the PRA can apply if (i) the Bank of England has informed the PRA that it is satisfied that Condition 2 in section 7 is met and the Bank of England has consented to the application and (ii) the PRA is also satisfied that certain conditions are met.

There are various technical differences between the winding up of an English Company under the Insolvency Act 1986 and the Building Society Insolvency Procedure, but these have no material effect on our conclusions in relation to the issues discussed in this memorandum.

(c) Building Society Special Administration Procedure

As noted above, the BSISA Order and section 90C of the Building Societies Act 1986 also apply Part 3 of the Banking Act to English Building Societies, with appropriate modifications, under the name "building society special administration" (the **Building Society Special Administration Procedure**).

The Building Society Special Administration Procedure is based on the existing provisions for the administration of an English Company, as described in this memorandum, but adapted to further the purposes of the Banking Act. In particular, it is intended to be used in relation to a failing English Building Society where there has been a partial transfer of business from the failing English Building Society to a private sector purchaser or bridge bank.[268] The building society special administrator appointed by the court would be empowered and required to ensure that the non-transferred part of the English Building Society (referred to as the "residual building society" in the BSISA Order), the residual entity, provides services or

268 In relation to the Dunfermline Building Society (regarding which see note 265), both of these occurred. The private sector purchaser was Nationwide Building Society, to which were transferred retail and wholesale deposits, the employees, the head office and branch network and originated mortgages. Housing association loans and deposits were transferred to a bridge bank. The residual entity (which retained the commercial loan book, acquired mortgage portfolios and all subsidiaries of Dunfermline Building Society bar one) was placed into the Building Society Special Administration Procedure.

facilities required to enable a private sector purchaser or bridge bank that has acquired the transferred business to operate effectively.

The detailed operation of the Building Society Special Administration Procedure is subject to the Building Society Special Administration (England and Wales) Rules 2010 (the **BSSA Rules**).[269] Part 5 of the BSSA Rules applies specified provisions of the Insolvency Rules 1986, with some modifications, to the process of the Building Society Special Administration Procedure, including the set-off provision in Rule 2.85. The modifications to Rule 2.85 for this purpose have no bearing on our conclusions in this memorandum.

The moratorium on enforcement under paragraph 43 and 44 of Schedule B1 to the Insolvency Act 1986 also applies to the Building Society Special Administration Procedure under section 145 of the Banking Act as it applies to English Banks under the Bank Administration Procedure.

The Building Society Special Administration Procedure would be initiated by the Bank of England making an application to the court for a building society special administration order under section 142 of the Banking Act, as modified by section 90C of the Building Societies Act 1986.

There are various technical differences between the administration of an English Company under the Insolvency Act 1986 and the Building Society Special Administration Procedure, but these have no material effect on our conclusions in relation to the issues discussed in this memorandum.

2.3 *Winding Up Regulations*

As noted in our answer to question 20, the EC Insolvency Regulation does not apply to an English Building Society.

Instead, an English Building Society would be subject to the European cross-border insolvency law regime applicable to credit institutions under the Winding Up Directive, implemented in the United Kingdom by the Winding Up Regulations.

See paragraph 2.1 of Annex 1 and Appendix D of the ISDA Netting Opinion in respect of the treatment of New York law governed ISDA Master Agreements. See also paragraph 2.4 of Part 1 of Annex 1 hereto for additional discussion of the application of the various derogations in the Winding Up Regulations to the Credit Support Documents.

As noted in our answer to question 20, the Cross Border Insolvency Regulations would also not apply to an English Building Society.

2.4 *The FCA Regulations*

The protections afforded to financial collateral arrangements by the FCA Regulations upon insolvency apply in the context of one of the forms of insolvency proceeding under the Building Societies Act 1986. Regulation 8(3) of the FCA Regulations disapplies the moratorium on enforcement of security imposed by sections 10(1)(b) and 11(3)(c) of the Insolvency Act 1986.

269 SI 2010/2580.

The FCA Regulations also apply in the context of the Building Society Insolvency Procedure and the Building Society Special Administration Procedure. Schedule 2, paragraphs 1, 2 and 3 of the BSISA Order have the effect of applying the provisions of the Banking Act 2009 (Parts 2 and 3 Consequential Amendments) Order 2009 to English Building Societies (see the discussion at paragraph 2.5 of Part 1 of Annex 1 above in this regard) with the necessary modifications such that, taken as a whole, (i) references in the FCA Regulations to winding up (or liquidation) or administration include references to the Building Society Insolvency Procedure and the Building Society Special Administration Procedure, respectively, (ii) references to the provisions of the Insolvency Act 1986 include those provisions as applied and modified by section 90C of the Building Societies Act 1986 and the BSISA Order, and (iii) references to the provisions of the Insolvency Rules 1986 include those provisions as applied and modified by rules made under section 411(1A) of the Insolvency Act 1986, in relation to the Building Society Insolvency Procedure, and section 411(1B) of the Insolvency Act 1986, in relation to the Building Society Special Administration Procedure (section 411(3A) of the Insolvency Act 1986 states that in that section references to Part 2 or 3 of the Banking Act include references to those Parts as applied to building societies). In relation to (iii) and regulation 14 of the FCA Regulations, Rule 75 of the BSI Rules applies Rule 4.91 of the Insolvency Rules 1986 for the purposes of the mandatory set-off rule under the Building Society Insolvency Procedure and Rule 63 of the BSSA Rules applies Rule 2.86 for the purposes of the mandatory set-off rule under the Building Society Special Administration Procedure.

See paragraph 2.5 of Part 1 of Annex 1 hereto in relation to the interaction between the SRR and the FCA Regulations.

3 SECURITY DOCUMENTS

On the basis of the assumptions and subject to the qualifications in this memorandum as modified and supplemented by this Annex 3 and subject to the analysis set out in this Annex 3, we are of the view that the analysis in part III.3 of this memorandum of issues relating to the enforceability of the Security Documents against a Security Collateral Provider would apply in circumstances where the Security Collateral Provider is an English Building Society.

This is subject to section 104A of the Building Societies Act 1986, which provides that the Secretary of State may, by order made with the concurrence of the Treasury, provide that such of Part 25 of the Companies Act 2006 (that is, the Registration Provisions) as may be specified in the order shall apply in relation to English Building Societies, and charges created by English Building Societies, with such modifications as may be so specified. As of the date of this memorandum, however, no such order has been made. Therefore, the Registration Provisions do not apply in relation to an English Building Society.

4 ENGLISH TRANSFER ANNEX

On the basis of the assumptions and subject to the qualifications in this memorandum as modified and supplemented by this Annex 3 and subject to the analysis set out in this Annex 3, we are of the view that the analysis in part IV.3 of this memorandum of issues relating to the enforceability of the English Transfer Annex would apply in the event that insolvency proceedings are commenced in England in respect of the English Building Society.

We believe that the close-out netting provisions of the ISDA Master Agreement would be enforceable against an English Building Society in the event of its winding up, including under the Building Societies Act 1986, without reliance on a statutory insolvency set-off rule, for the reasons we give in part III.3(3)(a) of the ISDA Netting Opinion in relation to an

English Company on the basis that the close-out netting provisions of the ISDA Master Agreement do not involve contractual set-off (other than to the limited extent that it includes Unpaid Amounts owed by either party that became payable prior to the operation of Section 6(c)(ii) of the ISDA Master Agreement) but simply represent an accounting of rights and liabilities under a single agreement following the designation or deemed occurrence of an Early Termination Date (sometimes referred to as the "flawed asset" approach to close-out netting).

If, however, the court were to construe the close-out netting provisions of the ISDA Master Agreement as operating by way of contractual set-off rather than pursuant to the single agreement (or "flawed asset") approach described above, we also consider that the close-out netting provisions of the ISDA Master Agreement would be enforceable against an English Building Society. Our reasons for this view are principally those set out in part III.3(3)(a) of the ISDA Netting Opinion in relation to an English Company, supplemented by our view that in respect of an insolvency of an English Building Society under the Building Societies Act 1986 an English court would find that insolvency set-off applies, despite the fact that there is no statutory insolvency set-off rule. We believe this would be the result because it is clear, in our view, that the lack of insolvency rules for English Building Societies in an insolvency under the Building Societies Act 1986 is a failure of administration rather than a deliberate policy choice, much less an expression of the will of Parliament.

The policy reasons in favour of insolvency set-off for English Building Societies are as strong as they are in relation to individuals or companies, and there is a common law basis for the insolvency set-off provision which pre-dates its first appearance in statutory form in 1705. An English court would therefore, in our view, either find that insolvency set-off applies as a matter of common law in relation to an English Building Society in a winding up under the Building Societies Act 1986 or, alternatively, would find that the close-out netting provisions of the ISDA Master Agreement viewed as a form of contractual set-off do not offend against any mandatory rule of English insolvency law and are therefore enforceable in accordance with their terms.

In addition to the arguments above, if the English Transfer Annex forms part of a financial collateral arrangement under the FCA Regulations as discussed in part II above, regulation 12 provides that a close-out netting provision shall, subject to paragraph (2), take effect in accordance with its terms notwithstanding that the collateral-provider or collateral-taker under the arrangement is subject to winding-up proceedings or reorganisation measures.

Since the English Transfer Annex relies for its effectiveness on the inclusion of the Credit Support Balance within the scope of the close-out netting provisions in Section 6(e) of the ISDA Master Agreement, we are of the view that an English court would find that the title transfer collateral arrangement effected by the English Transfer Annex is enforceable against an English Building Society in the event of its winding up in England under the Building Societies Act 1986.

ANNEX 4

BANKING GROUP COMPANIES AND BANK HOLDING COMPANIES

In this Annex 4, we set out our views regarding the enforceability of the Credit Support Documents in the event that resolution action or insolvency proceedings are commenced in England in respect of a banking group company.

In this Annex: (i) 'Bank' has the meaning given in section 2 of the Banking Act; (ii) 'Building Society' has the meaning given in section 119 of the Building Societies Act 1986; (iii) 'Investment Firm' has the meaning given in section 258A of the Banking Act[270]; (iv) 'EU Institution' means a credit institution or investment firm which is incorporated in or formed under the law of any part of an EEA state other than the United Kingdom; and (v) 'Third Country Institution' has the meaning given to the term in Part 2 of Annex 1 of this memorandum.

The definition of banking group company in the Banking Act is complex. A **Banking Group Company** under this Annex 4 means an English Company which (i) is (or would, but for the exercise of a stabilisation power, be) in the same group as a Bank, Building Society, Investment Firm, EU Institution or Third Country Institution and (ii) is not excluded under the Banking Group Companies Order (as discussed in more detail below). [271]

Subject to the more detailed discussion below, a Banking Group Company may be subject to each type of insolvency proceeding that may be commenced in England in relation to an English Company as set out in part III.1(4) of the ISDA Netting Opinion. A Banking Group Company may also be subject to the SRR in Part 1 of the Banking Act and the Bank Administration Procedure.

In this Annex 4, we also consider the power of the Treasury to take a Bank Holding Company into temporary public ownership. For this purpose a **Bank Holding Company** is an English Company that is the parent undertaking of a Bank, a Building Society or an Investment Firm.

Note that if an English Company is part of the group of a UK authorised person, the ring-fencing transfer scheme powers under Part VII of the Financial Services and Markets Act 2000 could also apply as discussed in more detail in Annex 1. 'Group' and 'authorised person' for this purpose are as defined in the Financial Services and Markets Act 2000 - an English Bank would be a UK authorised person.

1. Conclusion

On the basis of the assumptions and subject to the qualifications in this memorandum as modified and supplemented by this Annex 4, we are of the view that our conclusions in this memorandum in relation to an English Company would also apply to a Banking Group Company, including in the event of its becoming subject to: (a) one of the forms of insolvency proceeding under the Insolvency Act 1986; (b) the Bank Administration Procedure; or (c) the SRR.

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270 Referred to as an English Banking Act Investment Firm in the context of Annex 2 in respect of English entities only.

271 Note this includes where the Bank, Investment Firm or Building Society is elsewhere in the United Kingdom, but not banking group companies incorporated elsewhere in the United Kingdom.

2. Analysis

The conclusion in paragraph 1 of this Annex 4 is subject to the discussion below.

2.1 *Definition of a Banking Group Company*

As discussed above, under the Banking Act a "banking group company" means:

(a) an undertaking which is (or, but for the exercise of the stabilisation power, would be) in the same group as a Bank, a Building Society, an Investment Firm, a recognised central counterparty, EU Institution or Third Country Institution (each a **Relevant Entity**); and [272]

(b) that meets the conditions in the Banking Act 2009 (Banking Group Companies) Order 2014[273] (the **Banking Group Companies Order**).

For these purposes undertakings are in the same "group" if they are "group undertakings" in respect of each other as defined in the Companies Act 2006.

The Banking Group Companies Order requires that the relevant undertaking is a parent or subsidiary of the Relevant Entity or a group subsidiary of the Relevant Entity (that is a subsidiary of the parent but not a direct subsidiary of the Relevant Entity itself). Certain entities are excluded by the Banking Group Companies Order including certain mixed activity holding companies (**MAHC**). Where the Relevant Entity is a subsidiary of a MAHC and of a 'financial holding company' which is also a subsidiary of the MAHC, the MAHC is not a 'parent' of the Relevant Entity and a group subsidiary which is a subsidiary of the MAHC is also excluded unless it is a financial institution or a subsidiary of a financial institution which is also a subsidiary of the MAHC.

For this purpose:

(a) a MAHC is a parent (i) whose subsidiaries include at least one credit institution, investment firm or central counterparty; (ii) which is not itself a credit institution, investment firm or central counterparty; and (iii) which together with its subsidiaries, constitutes a group which fails to meet certain conditions in the Supplementary Supervision Directive[274] (or would fail to meet such conditions, if entities that are central counterparties or investments exchanges were deemed to be financial sector entities for that purpose); and

(b) a financial holding company is a parent (i) which is a financial institution; and (ii) whose subsidiaries are exclusively or mainly credit institutions, financial institutions, investment exchanges, investment firms or central counterparties.[275]

272 See section 81D of the Banking Act. Note we only consider Banking Group Companies that are English Companies and are part of a group including a Bank, Investment Firm, Building Society, EU Institution or Third Country Institution in this Annex. Note the Relevant Entity itself may be located elsewhere in the United Kingdom. Banking group companies under the Banking Act include undertakings in the same group as Building Societies and Investment Firms by virtue of sections 84 and 89A (respectively). The definition also includes undertakings in the same group as recognised central counterparties by virtue of section 89B. For these purposes "recognised central counterparty" has the meaning given by section 285 of the Financial Services and Markets Act 2000 except for recognised clearing houses that are also banks, building societies, credit unions or investment firms (section 89G of the Banking Act). We do not consider recognised clearing houses in this memorandum and neither do we consider entities that would be banking group companies as a result of being part of a group including such an entity.

273 2014/1831.

274 Directive 2002/87/EC.

275 See article 2 of the Banking Group Companies Order for the full definitions.

Also excluded from the definition of banking group companies are securitisation companies which are not investment firms or financial institutions.[276]

2.2 *Application of Part 1 of the Banking Act to a Banking Group Company*

The Bank of England may:

(a) transfer all or part of the business of a Banking Group Company to a private sector purchaser or a bridge bank if the conditions in section 81B of the Banking Act are satisfied;

(b) transfer all or part of the business of a Banking Group Company to an asset management vehicle if the conditions in section 81ZBA of the Banking Act are satisfied; and

(c) exercise the resolution instrument powers in accordance with section 12A(2) (Bail-in option) of the Banking Act in respect of the Banking Group Company if the conditions in section 81BA are satisfied.[277]

If the Relevant Entity is incorporated in the United Kingdom, the conditions for applying the SRR to the Banking Group Company include that (x) the PRA and the Bank of England (as appropriate) are satisfied that the general conditions in section 7 of the Banking Act are met in respect of the Relevant Entity and (y)(i) the Bank of England is satisfied the exercise of the power is necessary having regard to the public interest in the advancement of one or more of the special resolution objectives; or (ii) if the Treasury has provided financial assistance in respect of the Relevant Entity, the Treasury has recommended the exercise of such powers to protect the public interest and the Bank of England has determined such exercise is appropriate (other than in respect of bail-in as the conditions in (y)(i) will always apply to the exercise of the resolution instrument powers). If the Relevant Entity is an EU Institution or Third Country Institution, the relevant EEA or third country authority (as applicable) will need to be satisfied the equivalent tests in the relevant jurisdiction are met.

We assume that the relevant conditions are met if the SRR is applied to a Banking Group Company. In respect of a bail-in or a transfer of property to a private sector purchaser or a bridge bank (but not to an asset management vehicle in respect of which other additional conditions apply), the Bank of England must have regard to the need to minimise the effect of such measures on other group members.

Pursuant to sections 81C and 81CA of the Banking Act, the relevant stabilisation powers may be exercised in respect of the Banking Group Company that is part of a group including a Bank, EU Institution or Third Country Institution as if it were a Bank (subject to a number of modifications, in particular where the Banking Group Company is the ‘parent’).

As noted above, the relevant sections of the Banking Act relating to Banking Group Companies also apply where the Relevant Entity is an Investment Firm or a Building Society (since Part 1 of the Banking Act is applied to those entities as it applies to Banks). Therefore,

276 Securitisation companies are defined by reference to taxation legislation except that certain warehouse companies that would otherwise be securitisation companies are excluded from being securitisation companies. Covered bond vehicles are also excluded from being banking group companies but as these are limited liability partnerships these are not relevant for the purposes of this memorandum.

277 Section 48B(2) of the Banking Act states that special bail-in provision also includes any "associated provision", which is defined (at section 48B(3)) as provision cancelling or modifying a contract under which a banking group company has a liability.

where the Relevant Entity is an Investment Firm or a Building Society, the reference to the Banking Group Company being subject to the SRR as if it were a Bank should be read instead as being subject to the SRR as if it were an Investment Firm or Building Society. The SRR is modified in respect of an Investment Firm or Building Society. Particularly in respect of the modifications for Building Societies, it is unclear how exactly these would be applied to a Banking Group Company given the difference in legal forms.

Where a resolution instrument has been made in respect of a Building Society in relation to the exercise of the bail-in option, section 84D(5) of the Banking Act also makes express provision in respect of banking group companies in respect of Building Societies. In this circumstance, references to Banking Group Companies in sections 81BA and 81CA in respect of group bail-in should be read as references to subsidiaries of the Building Society and section 81D does not apply. Section 84D(5) also provides that a resolution instrument may only be made in respect of the Banking Group Company where a resolution instrument has also been made in respect of the parent Building Society.

Since the Banking Group Company is to be subject to the SRR as if it were a Bank, Building Society or Investment Firm, the Partial Property Safeguards Order and the Bail-in Safeguards Order will apply to the Banking Group Company. Note that partial property transfers are further restricted in respect of Banking Group Companies that are not financial institutions or parent undertakings of the Relevant Entity by article 9A of the Partial Property Safeguards Order. Article 9A provides that partial property transfers should only be made in such circumstances if it is necessary for carrying on the business or any part of the business, of the Relevant Entity or another Banking Group Company in the same group.

Subject to the discussion above, as the powers outlined in this paragraph 2.2 apply to a Banking Group Company as if it were a Bank, Building Society or Investment Firm (as applicable), the relevant analysis in respect of such English entities at Annex 1, Annex 2 and Annex 3 of this memorandum also applies to a Banking Group Company.[278]

2.3 *The Bank Administration Procedure*

Pursuant to sections 81C and 81CA of the Banking Act, the Bank Administration Procedure may be applied to a Banking Group Company that is part of a group including a Bank, EU Institution or Third Country Institution as if it were a Bank (subject to a number of modifications). As noted above, the relevant sections of the Banking Act relating to Banking Group Companies also apply where the Relevant Entity is an Investment Firm or a Building Society (since Part 1 of the Banking Act is applied to those entities as it applies to Banks).

Therefore, where the Relevant Entity is an Investment Firm or a Building Society, the reference to the Banking Group Company being subject to the Bank Administration Procedure as if it were a Bank should be read instead as being subject to Bank Administration Procedure as if it were an Investment Firm or Building Society. The Bank Administration Procedure is modified (and renamed) in respect of Building Societies as discussed in Annex 3 due to the mutual nature of a Building Society – therefore it is unclear how exactly it would be applied to a Banking Group Company given the difference in legal forms.

Subject to the discussion above, as the Bank Administration Procedure (or Building Society Special Administration Procedure) applies to a Banking Group Company as if it were a Bank,

278 We assume given that the Banking Group Company we refer to in this Annex is an English Company and its COMI is in England (see assumption 3(j) in part I), that it would be the Banking Act regime as applicable in England that would be relevant even where the Relevant Entity was located elsewhere in the UK. We do not consider the Banking Act as it applies elsewhere in the UK.

an Investment Firm or Building Society (as applicable), the relevant analysis in respect of such English entities at Annex 1, Annex 2 and Annex 3 of this memorandum also applies to a Banking Group Company. [279]

2.4 *Bank Holding Companies*

Under section 82 of the Banking Act, a Bank Holding Company may, in certain circumstances, be taken into temporary public ownership. The Banking Act SRR Code of Practice provides that this should be used as a last resort after having assessed and exploited other resolution tools to the greatest extent possible whilst maintaining financial stability.

Once the Bank Holding Company has been taken into temporary public ownership, section 83 provides for various powers under the Banking Act to apply including section 45 (Temporary public ownership: property transfer) and sections 65 to 68 (in respect of the continuity obligations). These would apply to the Bank Holding Company broadly as they would apply to a Bank, an Investment Firm or Building Society (as applicable) including the application of the Partial Property Safeguards Order.

As the powers outlined in this paragraph 2.4 apply substantially to a Bank Holding Company as if it were a Bank, an Investment Firm or Building Society (as applicable), our analysis in respect of each such English entities in Annex 1, Annex 2 and Annex 3 of this memorandum also applies to a Bank Holding Company.[280]

2.5 *The Winding Up Regulations*

A group company within the scope of regulation 44 of the Winding Up Regulations is subject to the Winding Up Regulations if (i) a stabilisation instrument has been made in respect of a UK group company or (ii) a resolution tool or resolution power (provided for in the BRRD) has been exercised in respect of an EEA group company (as applicable). It is therefore not possible for the UK to wind up or resolve an EEA group company with its head office in an EEA state other than the UK where one or more of the resolution tools or resolution powers have been applied.

In respect of any Banking Group Company or Bank Holding Company within the scope of regulation 44 of the Winding Up Regulations, we assume the head office is in England and it is not otherwise subject to the Regulations and therefore it would be a 'UK group company'.

Furthermore, see paragraph 2.1 of Annex 1 and Appendix D of the ISDA Netting Opinion in respect of the treatment of New York law governed ISDA Master Agreements. See also paragraph 2.4 of Part 1 of Annex 1 hereto for additional discussion of the application of the various derogations in the Winding Up Regulations to the Credit Support Documents.

2.6 *The FCA Regulations*

See paragraph 2.5 of Part 1 of Annex 1 hereto in relation to the application of the FCA Regulations in the context of the Bank Administration Procedure and the interaction between the SRR and the FCA Regulations.

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279 See note 278 above in respect of the intra-UK jurisdictional issue.

280 See note 278 above in respect of the intra-UK jurisdictional issue.

3. SECURITY DOCUMENTS AND ENGLISH TRANSFER ANNEX

On the basis of the assumptions and subject to the qualifications in this memorandum as modified and supplemented by this Annex 4 and subject to the analysis set out in this Annex 4, we are of the view that the analysis in parts III.3 and IV.3 of this memorandum of issues relating to the enforceability of the Security Documents and the English Transfer Annex would apply to a Banking Group Company or Bank Holding Company.

ANNEX 5

TRUSTEE OF AN ENGLISH TRUST

In this Annex 5, we set out our views on the enforceability of the Credit Support Documents against a Trustee of an English Trust in the event that insolvency proceedings are commenced in England in respect of the Trustee or the English Trust is wound up.

In this Annex 5, as noted in part I.2 of this memorandum, we only consider an English Trust that is not an English Charitable Trust, Authorised Unit Trust or other form of trust subject to a special regulatory regime, such as an occupational pension scheme. In Annex 12 we consider how the principles below apply in the case of a Trustee of an English Charitable Trust. In Annex 15 we consider how the principles below apply in the case of a Trustee of an Authorised Unit Trust. As noted in part I.2 of this memorandum, any other form of English Trust that is subject to a special regulatory regime that may affect the enforceability of the Credit Support Documents is beyond the scope of this memorandum.

Subject to the more detailed discussion below, the types of insolvency proceeding that may be commenced in England in respect of a Trustee are the same as those that would apply in respect of an English Company, as described in part III.1(4) of the ISDA Netting Opinion, since we have assumed in part I.2 of this memorandum that the Trustee is an English Company.

If the English Trust itself (rather than the Trustee) were to become insolvent, the English Trust would not be wound up under English insolvency legislation as it is not a legal person. Instead, the following possibilities exist:

(I) the Trustees could wind up the English Trust in various circumstances, provided that the trust deed confers this power on the Trustees and the relevant circumstances have occurred; and

(II) the court could make an administration order[281] in relation to the English Trust under Rule 64.2 of the Civil Procedure Rules 1998.

Under Rule 64.2 of the Civil Procedure Rules 1998, the execution of the English Trust would be carried out under the direction of the court. The court would only make an administration order if it considered that the issues between the parties could not properly be resolved in any other way.

Due to the fact that the English Trust is not a legal person, we also assume for the purpose of this Annex 5 that the Trustee entered into the ISDA Master Agreement, Credit Support Document, and each Transaction prior to (i) the insolvency of the English Trust or (ii) the making of an administration order in respect of the English Trust under Rule 64.2 of the Civil Procedure Rules 1998.

281 Referred to as an "administration order" under this Rule, but not to be confused with an administration order under Part II of the Insolvency Act 1986.

We consider below the enforceability of the Credit Support Documents in the following three cases:

(I) where there is more than one Trustee and insolvency proceedings are commenced in England in respect of at least one Trustee but one or more solvent Trustees remain that are parties to the ISDA Master Agreement and Credit Support Document (a **Partial Trustee Insolvency**);

(II) where there is a single Trustee and insolvency proceedings are commenced in England in respect of it or there is more than one Trustee and insolvency proceedings are commenced in England in respect of each Trustee (a **Full Trustee Insolvency**); and

(III) where the English Trust is insolvent, in the sense that the assets held on trust are insufficient to meet the liabilities incurred by the Trustees on behalf of the English Trust (a **Trust Insolvency**).

Partial Trustee Insolvency

A Partial Trustee Insolvency would normally fall within the Section 5(a)(vii) (Bankruptcy) Event of Default in the ISDA Master Agreement. A party to an ISDA Master Agreement with an insolvent Trustee may not, however, wish to exercise its right to designate an Early Termination Date in relation to the Trustee for the following reasons:

(a) on a Partial Trustee Insolvency, on the assumption that all the Trustees would be jointly and severally liable for the obligations under the Credit Support Document, a party would be entitled to proceed against any of the remaining Trustees who would have recourse to the assets of the English Trust to meet that liability (regarding which, see Appendix D); and

(b) a Partial Trustee Insolvency would not affect the enforceability of the Credit Support Documents against each remaining solvent Trustee which is party to the ISDA Master Agreement and Credit Support Document or interfere with the direct recourse of any such Trustee to the assets of the English Trust to satisfy its obligations under the Credit Support Document, subject to the discussion in Appendix D.

Full Trustee Insolvency

A Full Trustee Insolvency (like a Partial Trustee Insolvency) would normally fall within the Section 5(a)(vii) (Bankruptcy) Event of Default in the ISDA Master Agreement.

We believe that it is unlikely that an English Trust would be left without any solvent Trustees. In other words, under normal circumstances it is unlikely that a Full Trustee Insolvency would occur and persist for a significant period of time.[282] Where there is more than one Trustee, it is unlikely that all of the Trustees would be simultaneously insolvent.

Where there is a sole Trustee which becomes insolvent, the trust deed would normally provide that a person identified in the trust deed may select a new Trustee, and the court has a statutory power to appoint a new Trustee subject to certain conditions specified by statute.[283] Following such substitution, a party, by subrogation to the original Trustee's right of indemnity, would (until the dissolution of the previous Trustee) be entitled to enforce its subrogated right of indemnity against the trust assets directly, regardless of the fact that the

282 Although this risk is increased if there is a single Trustee.

283 Section 41 of the Trustee Act 1925, which expressly envisages that a court could use the power in order to appoint a new trustee in substitution for a corporate trustee which is in liquidation or has been dissolved.

newly-appointed Trustee would not be liable for the previous Trustee's liabilities. As such right would arise by subrogation to the right of the original Trustee, it would be limited to the extent of the original Trustee's right of indemnity, which may have been lost or limited by breach of trust by that Trustee, as discussed in Appendix D. Note, however, that ultimately the insolvent Trustee will be dissolved and at that point the creditor may not be able to rely on the right of subrogation as the Trustee no longer exists.

A party may agree with the new Trustee and the previous Trustee a novation of the previous Trustee's rights and obligations under the ISDA Master Agreement and the Credit Support Documents to the new Trustee. In this case, a party will be dealing with the new Trustee (and relying on the new Trustee's recourse to the trust assets) rather than seeking to enforce its subrogated right of indemnity by virtue of the previous Trustee's right of indemnity.

On the assumption that the English Trust is solvent, an insolvent Trustee (and a third party by subrogation) will still be able to enforce its claim against the trust assets, provided the Trustee has not lost its right of recourse in one of the ways described in Appendix D. In any event, as mentioned above, we believe that a Full Trustee Insolvency would normally be unlikely to occur and endure for a significant period of time as a matter of practice.

Trust Insolvency

As noted above, as an English Trust is not a legal person, it is not subject to the insolvency legislation of the type that applies to legal persons.[284] An English Trust may, however, be wound up, if the trust deed so provides and any relevant conditions or requirements of the trust deed are satisfied. It is also possible for the court to make an administration order in relation to the English Trust under Rule 64.2 of the Civil Procedure Rules 1998, under which the administration of the English Trust will be carried out by court.

Usually an English Trust, particularly if it is solvent, will be wound up by its Trustees, rather than by the court, in accordance with the terms of the trust deed. This may be on a solvent or an insolvent basis. This type of winding up is not under the supervision of the court.

There are no mandatory set-off rules that apply if an English Trust is wound up (i) in accordance with its trust deed or (ii) under an administration order made under Rule 64.2 of the Civil Procedure Rules 1998. In the latter case it is possible that the court would apply the same mandatory insolvency set-off rules that would have applied if the English Trust were a legal person (that is, a natural person subject to section 323 of the Insolvency Act 1986 or an English Company subject to Rule 2.85 or Rule 4.90 of the Insolvency Rules 1986).

As in the case of a Full Trustee Insolvency as discussed below, the technical issue may be raised that there is insufficient mutuality between the creditor and the English Trust (viewed, in effect, as a "quasi-person" for purposes of the winding up) for a right of insolvency set-off to apply in these circumstances. However, we believe that an English court would find that there was mutuality for this purpose for the reasons set out below.

If the court did make an order under Rule 64.2, it has broad discretion, as there is no provision in the Civil Procedure Rules 1998 directing how the court should direct the execution of the English Trust. However, the Trust Law Committee in the 1997 Consultation Paper suggests

284 See, for example, *Gilbert Deya Ministries v Kashmir Broadcasting Corporation Ltd* [2010] EWHC 3015 (Ch), where the court held that a charitable trust is not an unregistered company for purposes of Part V of the Insolvency Act 1986, which provides for the winding up of unregistered companies. The same would be true of any trust, whether or not established for charitable purposes.

that the court would divide the assets of the insolvent trust in the following priority: (i) secured creditors; (ii) costs of realisation of assets; (iii) preferential creditors; and (iv) floating charges in the order of creation.[285] After that it is uncertain what the court would direct, though it is clear that a creditor with an indirect claim on the trust assets by way of subrogation to a Trustee's right of reimbursement would be limited to the sum that such Trustee could claim.

In relation to an English Trust, it is possible for the trust deed to contain a provision stating that a certain event will trigger the winding up of the English Trust or providing that one or more persons (for example, the person who created the English Trust, usually referred to as the "grantor" or "settlor" of the English Trust) have the right to trigger a winding up of the English Trust under the trust deed. In either case or under any other provision of the trust deed requiring or permitting the winding up of the Trust, it would normally be the Trustees who carry out the winding up.

If an English Trust were wound up, the assets of the English Trust would be applied to satisfy the liabilities validly incurred by the Trustees on behalf of the English Trust. If there were insufficient assets to cover the entirety of those liabilities, we believe that the assets would be applied in the priority order suggested by the Trust Law Committee in the 1997 Consultation Paper as discussed above.

Provided the Trustee's right of recourse to the trust assets is not impaired as discussed in Appendix D, then it will have a right of recourse to the trust assets secured by its lien that will enable the Trustee to use the assets of the English Trust to pay creditors in priority to the beneficiaries. In other words, the rights of the beneficiaries of an English Trust are subordinate to the Trustee's right of recourse.

The foregoing events relating to a Trust Insolvency would not fall within the Section 5(a)(vii) (Bankruptcy) Event of Default in the ISDA Master Agreement. Accordingly, we recommend that an additional Event of Default be added to the Schedule to the ISDA Master Agreement providing that the occurrence of any of the foregoing events in relation to the Trust will constitute an Event of Default in relation to the Trustee(s).

1. SECURITY DOCUMENTS

Conclusion

On the basis of the assumptions and subject to the qualifications in this memorandum as modified and supplemented by this Annex 5 and subject to the analysis set out in this Annex 5, and subject also to the further assumptions that the relevant Security Document creates a fixed charge on the Posted Credit Support delivered by the Security Collateral Provider to the Secured Party under that Security Document and that in the case of the New York Annex, the parties have elected that Paragraph 13(e)(ii) is applicable so that the Pledgor must obtain the Secured Party's consent for any substitution of Posted Credit Support pursuant to Paragraph 4(d) of the New York Annex, we are of the view that:

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285 We note that in the 1999 report, the Trust Law Committee states that it seems likely that the priority order that the court would lay down would be (1) creditors with fixed charges, (2) creditors with floating charges, (3) preferential creditors, (4) general creditors. No explanation is given for the change of the position of preferential creditors and creditors with floating charges between the 1997 Consultation Paper and the 1999 Report. Given that the position in the 1997 Consultation Paper reflects the priority position on the winding up of a company, and that there is no explanation for the change, we believe the true view of the Trust Law Committee is that set out in the 1997 Consultation Paper.

(i) the analysis in part III.3 of this memorandum of issues relating to the enforceability of the Security Documents against a Security Collateral Provider would apply in circumstances where the Security Collateral Provider is a Trustee of an English Trust (see the discussion of the English Transfer Annex below in relation to the avoidance of transactions in a Trust Insolvency);

(ii) this memorandum discusses the circumstances in which the Security Documents might constitute a floating charge on Posted Credit Support (for example, if the Security Collateral Provider has an unrestricted right of substitution of Posted Credit Support). In most circumstances, however, the Security Documents would constitute a fixed charge. If that is not the case, certain additional issues could arise where the Security Collateral Provider is the Trustee; and

(iii) the analysis in part III.3 of this memorandum relating to registration, filing and perfection of title for an English Company (as defined in the body of this memorandum) would remain unchanged for a Trustee.

The above conclusions are qualified by the fact that there are circumstances in which a delivery of Eligible Collateral by a Trustee would not take effect solely in accordance with its terms as expressed by the Security Documents. In circumstances where a Trustee, acting outside its powers, transfers Eligible Collateral, such Trustee will be liable to the beneficiaries of the trust for loss caused by such breach of trust. Under general equitable principles, this liability will not affect the party contracting with a Trustee provided that such party (a) gave value for the property or obligations, (b) acted in good faith in acquiring the legal title to such property or obligations, and (c) did not have notice (including constructive notice)[286] that the Trustee was acting inconsistently with the terms of the trust. If such party fails to fulfil any of these three conditions, it may be held to be a constructive Trustee of the Eligible Collateral for the beneficiaries of the trust. If the party contracting with a Trustee had notice of the breach of trust, it may also incur personal liability as a knowing recipient of the trust property and, if such party acts dishonestly, it may also incur liability for "knowing assistance".

On the assumption that the Trustee is authorised by the rules of the Trust to enter into the ISDA Master Agreement and to provide collateral by way of security, the Trustee would be acting within the terms of the trust by transferring or receiving Eligible Collateral under the Security Documents. We are not aware of any general restriction preventing a Trustee of an English Trust validly transferring or receiving Eligible Collateral under the Security Documents, provided that the trust deed permits the Trustee to hold the particular type of Eligible Collateral transferred.

2. ENGLISH TRANSFER ANNEX

Conclusion

We now consider the extent to which the analysis of the English Transfer Annex in part IV of this memorandum applies in relation to the enforceability of the English Transfer Annex against the Trustees of an English Trust. Our conclusions are as follows:

286 The precise test for constructive notice in the commercial context is subject to some debate. The party contracting with the Trustee may be considered to have knowingly assisted the Trustee in breach of the trust where it has (i) knowledge that the transaction involved a misapplication of trust property (of which dishonesty is an essential element, objectively assessed against the standard of an honest person, with regard to the contracting party's experience); (ii) deliberately disregarded or failed to make inquiries into a transaction which it suspected was in breach of such trust; or (iii) the party's state of knowledge is such as to make it unconscionable for him to retain the benefit of the receipt. See Martin J *Modern Equity* (20th edn Sweet & Maxwell, 2015), paras 25-10 to 25-23.

(i) ***Title transfer***

Would the laws of England characterise each transfer of Eligible Credit Support as effecting an unconditional transfer of ownership in the assets transferred? Is there any risk that any such transfer would be recharacterised as creating a security interest? If so, is there any way to minimise such risk? What would be the consequences of such a recharacterisation?

The opinion contained in this memorandum regarding recharacterisation risk applies equally to an English Transfer Annex entered into with a Trustee.

However, there are circumstances in which a transfer of Eligible Credit Support by a Trustee would not effect an unconditional transfer of ownership in the assets transferred. In circumstances where a Trustee, acting outside its powers, transfers Eligible Credit Support, such Trustee will be liable to the beneficiaries of the trust for loss caused by such breach of trust. Under general equitable principles, this liability will not affect the party contracting with a Trustee provided that such party (a) gave value for the property or obligations, (b) acted in good faith in acquiring the legal title to such property or obligations, and (c) did not have notice (including constructive notice)[287] that the Trustee was acting inconsistently with the terms of the trust. If such party fails to fulfil any of these three conditions, it may be held to be a constructive Trustee of the Eligible Credit Support for the beneficiaries of the trust; in other words, the purported transfer by the Trustees would not be effective to transfer beneficial ownership of the Eligible Credit Support to such party. If the party contracting with a Trustee had notice of the breach of trust, it may also incur personal liability as a knowing recipient of the trust property and, if such party acts dishonestly, it may also incur liability for "knowing assistance".

On the assumption that the Trustee is authorised by the rules of the Trust to enter into the ISDA Master Agreement and to provide collateral by way of title transfer, the Trustee would be acting within the terms of the trust by transferring or receiving Eligible Credit Support under the English Transfer Annex. We are not aware of any general restriction preventing a Trustee of an English Trust validly transferring or receiving Eligible Credit Support under the English Transfer Annex, provided that the trust deed permits the Trustee to hold the particular type of Eligible Credit Support transferred.

We are of the opinion that the analysis in Questions 23, 24 and 29 of this memorandum relating to unconditional transfer of title and filing or perfection requirements would remain unchanged where the counterparty is a Trustee.

A separate issue that must be considered in the case of a Trustee is whether the Trustee will have a right of recourse to the trust in order to meet its obligation (if any) to transfer Equivalent Credit Support under the English Transfer Annex where it is acting as Transferee. As discussed above, if a Trustee acts outside the terms of the trust, it will not have recourse to the Trust to meet obligations incurred. Where a contracting party transfers Eligible Credit Support to a Trustee and the Trustee acted outside its powers when entering into the English Transfer Annex, if the contracting party is subsequently entitled to the return of Equivalent Credit Support, it may have only a personal contractual claim against the Trustee for the return of Equivalent

287 See note 286 above.

Credit Support. In this situation, such party may be able to rely on a restitutionary claim against the trust assets as discussed in Appendix D.

(ii) ***Validity of Paragraph 6 of the Transfer Annex***

Assuming that Section 6 of the ISDA Master Agreement is valid and enforceable in England insofar as it relates to the determination of the net amount payable by either party on the termination of the Transactions, please confirm that Paragraph 6 of the English Transfer Annex would also be valid to the extent it provides for the Value of the Credit Support Balance to be included in the calculation of the net amount payable under Section 6(e) of the ISDA Master Agreement.

On the assumption that Section 6 of the ISDA Master Agreement is valid and assuming that the Transferee receives an absolute ownership interest in the Collateral, Paragraph 6 of the English Transfer Annex would also be valid to the extent it provides for the Value of the Credit Support Balance to be included in the calculation of the net amount payable under Section 6(e) of the ISDA Master Agreement.

(iii) ***Single Trustee Insolvency, Full Trustee Insolvency or Trust Insolvency***

Would the rights of the Transferee be enforceable in accordance with the terms of the ISDA Master Agreement and the English Transfer Annex, irrespective of the occurrence of a Partial Trustee Insolvency, Full Trustee Insolvency or a Trust Insolvency?

In relation to the issues discussed in Question 26 of this memorandum, assuming that the Transferee receives an absolute ownership interest in the Collateral, the English Transfer Annex would be enforceable against a Trustee irrespective of the occurrence of a Trust Insolvency, Partial Trustee Insolvency or Full Trustee Insolvency, subject to the issues regarding mutuality discussed below.

If a Full Trustee Insolvency were to occur, we believe that the ISDA Master Agreement and all Transactions (including that represented by the English Transfer Annex) entered into between a party and the Trustee would be considered as a single agreement between the party and the Trustee. For the reasons given in part III.3(3)(a) of the ISDA Netting Opinion, we believe that an English court would construe the close-out netting provisions of the ISDA Master Agreement (together with Paragraph 6 of the English Transfer Annex) as not involving contractual set-off (other than to the limited extent that it includes Unpaid Amounts owed by either party that became payable prior to the operation of Section 6(c)(ii) of the ISDA Master Agreement, as discussed in the ISDA Netting Opinion) but simply as representing an accounting of rights and liabilities under a single agreement following the designation or deemed occurrence of an Early Termination Date in the event of a Full Trustee Insolvency. As noted in the ISDA Netting Opinion, this is sometimes referred to as the "flawed asset" approach to contractual netting.

If, however, the court were to construe the close-out netting provisions of the ISDA Master Agreement as operating by way of contractual set-off rather than pursuant to the single agreement (or "flawed asset") approach discussed above, we also consider that the close-out netting provisions of the ISDA Master Agreement would be enforceable against each Trustee in a Full Trustee Insolvency under English law. Our reasons for this view are principally those set out in part III.3(3)(a) of the ISDA

Netting Opinion. In relation to netting against a Trustee, however, there is an additional issue that must be considered.

Insolvency set-off under Rule 2.85 of the Insolvency Rules 1986, in the event of administration proceedings, or Rule 4.90 of the Insolvency Rules 1986, in the event of winding up proceedings, is limited to mutual obligations. This gives rise to a technical issue when a Trustee enters into any contract on behalf of an English Trust, even if the Trustee is acting within its powers when entering into the contract, as there is an argument that there are no mutual obligations between a Trustee and its contracting party under the contract.

The argument runs as follows: the Trustee is not beneficially entitled to any obligations owed by the other party as the benefit of such obligations are owned by the beneficiaries of the English Trust. However, the contractual obligations are owed by the Trustee (because it is a party to the contract) and the Trustee is therefore liable in its personal capacity even though the contract is for the benefit of the English Trust.

It was acknowledged by the Trust Law Committee in the 1997 Consultation Paper that, if it is correct that the foregoing constitutes a lack of mutuality barring insolvency set-off, then this position is most unsatisfactory for the Trustee and its contracting party. We do not believe, however, that this position is correct for the reasons given below.

In relation to an ISDA Master Agreement, the purported lack of mutuality will not be an issue prior to an administration or liquidation of the Trustee as the ISDA Master Agreement between the Trustee and the other party will take effect according to its terms, given our assumptions as to legal capacity and due authorisation of each of the parties. However, this issue could arise in the event of the administration or liquidation of the Trustee.

Arguments in favour of mutuality

Given the strong policy in favour of insolvency set-off in English law, we think that in a Full Trustee Insolvency the obligations owed by each Trustee to the other party under an ISDA Master Agreement and the obligations owed by the other party to the Trustee for the benefit of the English Trust would be treated as mutual notwithstanding the technical argument that the respective obligations are not mutual because each Trustee is personally liable for the obligations it owes but not beneficially entitled to the obligations it is owed for the benefit of the English Trust.

Notwithstanding the technical argument, the Trustee has incurred its obligations solely for the purposes of the English Trust and, subject to the issues discussed in Appendix D, it is entitled to indemnification out of the assets of the English Trust. Any obligations of the other party are owed to the Trustee, but solely for the benefit of the English Trust. Substantively, therefore, there is mutuality at the level of the English Trust. All amounts owed by and to a Trustee for purposes of the English Trust should therefore, in our view, be considered mutual for the purposes of insolvency set-off against the Trustee.

The Trust Law Committee, in the 1997 Consultation Paper and the 1999 Report, suggested that, on a Trust Insolvency where an application to court was made under

Rule 64.2 of the Civil Procedure Rules, the court might treat the English Trust as a "quasi-person" involved in bilateral mutual dealings with a contracting party and would apply similar insolvency set-off rules to those that would apply if the trust fund were an individual or a company. This would be particularly relevant where, as would typically be the case, the Trustee has limited its liability under the ISDA Master Agreement to the value of the trust assets and the other party's remedies are therefore limited to its indirect right of recourse (by subrogation to the Trustee's right of recourse) to the trust assets (in other words to the insolvent trust fund).

Furthermore, if the Trustee becomes insolvent, provided that the Trustee has not lost its right of indemnity in one of the ways described in Appendix D, the Trustee will still have recourse to the trust fund in relation to any obligations owed by it under the ISDA Master Agreement, secured by its Trustee's lien, and so will have a beneficial interest in the English Trust to the extent of this right of recourse. There is an argument that this would give the Trustee a beneficial interest in the trust fund (including the benefit of the obligations owed by the other party) such that the Trustee could be described as being beneficially entitled to the other party's obligations, thereby establishing mutuality (although we note that the Trust Law Committee, in the 1997 Consultation Paper, was not convinced that this argument would be successful).

The other party may also have a direct right of recourse to the trust assets (subject to the qualifications referred to above and in Appendix D), particularly if the ISDA Master Agreement provides that the other party's right of recourse is to the trust assets rather than to the Trustee in its personal capacity. Such a right of recourse may mean that the English court would allow set-off between the other party and the trust fund on this basis.

The foregoing are essential technical arguments to rebut technical objections based on a characterisation of mutuality for set-off purposes as requiring personal liability and beneficial entitlement to be united in the same person acting in the same capacity in relation to each liability and entitlement. However, the policy which underlies the principle of mutuality in relation to set-off is that one person's assets should not be used to satisfy another person's creditors.

Accordingly, the formulation of the mutuality requirement narrowly in terms of personal liability and beneficial entitlement is, in our view, not appropriate to claims where a Trustee is attempting to set off claims owed to the Trustee for the benefit of the English Trust against claims owed by the Trustee that were incurred on behalf of the same trust. In other words, this analysis of mutuality does not take into account the special nature of an English Trust under English law. While the purpose of the English Trust is, among other things, to permit a separation of legal ownership and beneficial ownership, nonetheless many rules of trust law are based upon an identification of the interests of a Trustee with those of the beneficiaries for a variety of purposes. In the case of set-off, permitting an obligation owed to the Trustee (which is a trust asset) to be discharged by set-off of a liability of the Trustee incurred legitimately for the benefit of the English Trust manifestly does not offend against the policy of not permitting one person's asset (the trust asset) being used to discharge another person's liability (the Trustee's liability on behalf of the English Trust). This is because the Trustee's liability is only "personal" in the sense that, as a technical matter, a creditor may not proceed against the beneficiaries directly (other than in exceptional circumstances not relevant to the facts you have asked us to assume).[288] But it is a special type of liability which, as a matter of trust law, carries with it a special right, namely, the right of recourse to the assets of the English Trust in priority to the rights of the beneficiaries.

On the other hand, an English court would clearly not permit an obligation owed to a Trustee for the benefit of the trust fund to be set-off against a purely personal liability of the Trustee (that is, one incurred solely for its own benefit). Clearly this latter case would offend against the policy mentioned above. Therefore, we believe that an English court is highly likely to view obligations owed to a Trustee for the benefit of an English Trust as mutual with obligations owed by the Trustee that were legitimately incurred for the benefit of the English Trust and therefore to permit insolvency set-off of such obligations, whether in the case of a Full Trustee Insolvency or a Trust Insolvency.

In *Penwith District Council v V P Developments Limited*[289] Laddie J adopted similar reasoning in respect of the availability of equitable set-off and found a set-off to be available although note that the set-off in that case was equitable rather than insolvency set-off.[290]

We therefore consider that the strong weight of informed opinion supports the view that there would be sufficient mutuality between the respective obligations for a right of set-off to be available on a liquidation of the Trustee or an insolvency of the trust fund, although there is no case law to support this view. If the court were to treat the respective obligations as mutual, Section 6(e) of the ISDA Master Agreement (including Paragraph 6 of the English Transfer Annex) should work even on the basis of an insolvency set-off analysis.

In addition to the arguments above, in respect of a Full Trustee Insolvency, if the English Transfer Annex forms part of a financial collateral arrangement under the FCA Regulations as discussed in part II above, regulation 12 provides that a close-out netting provision shall, subject to paragraph (2), take effect in accordance with its terms notwithstanding that the collateral-provider or collateral-taker under the arrangement is subject to winding-up proceedings or reorganisation measures.

(iv) ***Avoidance of transfers under the English Transfer Annex***

Will the Trustee (or its administrator, provisional liquidator, receiver, trustee or other similar official) be able to recover any transfers of Eligible Credit Support made to the Transferee during a certain "suspect period" preceding the date of the insolvency? If such a period exists, would the substitution of Eligible Credit Support by a counterparty during this period invalidate an otherwise valid transfer if the substitute assets are of no greater value than the assets they are replacing? Would the transfer of additional Eligible Credit Support pursuant to the mark-to-market provisions of the English Transfer Annex during the suspect period be subject to avoidance, either because it was considered to relate to an antecedent or pre-existing obligation or for some reason?

288 See, for example, *Hardoon v Belilios* [1901] AC 118 (PC).

289 [2005] EWHC 259 (Ch)

290 See also the discussion in Derham, *Derham on the Law of Set-off* (4th Edition, OUP 2010), para 17.122 to 17.126

In relation to the issues referred to in Question 27 of this memorandum,[291] as noted above, the provisions of the Insolvency Act 1986 are not applicable to a Trust (as distinguished from the Trustees). Accordingly sections 238, 239, 244 and 245 of the Insolvency Act 1986 would not apply, and therefore those provisions are not relevant to a Trust Insolvency.

As discussed below, section 423 of the Insolvency Act 1986 might apply in certain circumstances on a Trust Insolvency.

The above sections of the Insolvency Act 1986 would, however, apply on a liquidation of a corporate Trustee.

However, in our view a liquidator or trustee in bankruptcy would not be able to reverse a margin transfer made by the Trustee for the benefit of the Trust, because the Trust, not the Trustee's general creditors, would receive any benefit that might be obtained from the reversal of that margin transfer.

Preferences in respect of an English Trust

The court has a general equitable power to avoid a transaction by virtue of which a debtor apparently treats one creditor preferentially relative to other creditors, where the creditor enjoying the preference knows at the time of the transaction that the debtor is in financial difficulties.[292]

While this jurisprudence is considered to have been displaced by the specific provisions of the Insolvency Act 1986 in relation to corporate insolvencies, it might still apply in relation to a non-corporate insolvency, such as the winding up of an English Trust. It is important to note that, in these circumstances, there is no specific time period, but rather a general vulnerability of transactions entered into where the relevant creditor knows (or should have known) that the debtor is in financial difficulty.

We consider it unlikely that the court would make an order of this type merely because a creditor dealt with an English Trust that was under-funded. We would suggest that something more would be required, similar to the requirements of section 239 of the Insolvency Act 1986 (which deals with preferences in relation to a corporate insolvency), namely, that there was an active intention of the debtor to put the creditor in a better position than other creditors in the event of its winding-up. Normally a transaction entered into at arm's-length where value is given and received contemporaneously (as opposed to consideration for a pre-existing debt, for example) will not be preferential in this sense.

However, the question of whether any particular action was preferential would depend on the facts and circumstances in question. See our answer to question 18 and 27 in part III and part IV for a further discussion of preferences under section 239 of the Insolvency Act 1986 in the context of a corporate insolvency.

291 Which cross-refers to the analysis in Part III Question 18 of this memorandum.

292 *Watts v Christie* (1849) 11 Beav 546, 50 ER 928.

Section 423

There is the possibility that a creditor of the Trustees could seek an order under section 423 of the Insolvency Act 1986 (transactions defrauding creditors) as this provision, notwithstanding the fact that it appears in the Insolvency Act 1986, may be invoked even where there are no insolvency proceedings under the Insolvency Act 1986. Also this provision, which is the latest incarnation of a very old rule against fraudulent conveyances, is available to any creditor of any person (not limited to companies) who has been defrauded by entry into a transaction at any undervalue by that person with a third person. There is no time limit on the application of this provision, so in theory the court could reopen and avoid a transaction entered into years ago (although in practice the older a transaction is the less likely the court is to do so). The definition of "transaction at an undervalue" is similar to the one used in section 238 of the Insolvency Act 1986. A party contracting with the Trustee who is acting in good faith and has given value will have a defence to such an order being granted.

Preferences and section 423 where English Trust subject to an administration order

It is possible that the English Trust could be subject to an administration order, as already mentioned above. In these circumstances, section 423 of the Insolvency Act 1986 and the old jurisprudence mentioned above relating to preferences would be relevant, the same considerations as described above applying, including no time limit in the former case and an indefinite time period in the latter case running from knowledge by the creditor of the debtor's financial difficulties.

(v) ***Governing law and submission to jurisdiction***

Would the parties' agreement on governing law of the English Transfer Annex and submission to jurisdiction be upheld in England, and what would be the consequences if it were not?

Our analysis remains unchanged from the analysis referred to in Question 28 of this memorandum.[293]

293 Which cross-refers to the analysis in Part III Question 19 of this memorandum.

ANNEX 6

FRIENDLY SOCIETY

In this Annex 6, we set out our views on the enforceability of the Credit Support Documents against a Friendly Society in the event that insolvency proceedings are commenced in England in respect of the Friendly Society. In this Annex 6 we consider only a Friendly Society that is neither an English Insurance Company nor an English Charity nor otherwise subject to a special regulatory regime. In Annex 10 we consider a Friendly Society that is an English Insurance Company, and in Annex 13 we consider a Friendly Society that is an English Charity.

Subject to the more detailed discussion below, the types of insolvency proceeding that may be commenced in England in respect of a Friendly Society are, pursuant to section 21 or 22 of the Friendly Societies Act 1992, a voluntary or compulsory winding up under the Insolvency Act 1986. It is also possible that a Friendly Society could be made subject to a scheme of arrangment under Part 26 of the Companies Act 2006.

Insolvency proceedings in respect of a Friendly Society

Sections 21 and 22 of the Friendly Societies Act 1992 provide that a Friendly Society may be wound up voluntarily (that is, by the creditors) or compulsorily (that is, by the court)[294]. Section 23 provides that "the companies winding up legislation" specified in paragraph 1 of Schedule 10 to the Friendly Societies Act 1992 shall apply, as modified by Parts I and II of Schedule 10. The winding up legislation specified in paragraph 1 of Schedule 10 consists of Parts IV, VI, VII, XII and XIII of the Insolvency Act 1986.

These provisions, as modified by the Friendly Societies Act 1992, apply the companies winding up provisions to Friendly Societies, but not the company voluntary arrangement provisions in Part I or the administration provisions in Part II of the Insolvency Act 1986. Section 255 of the Enterprise Act 2002 provides the Treasury with the power to provide by order for an administration regime for Friendly Societies. To date, no such order has been made by the Treasury.

It is unclear what insolvency rules would apply to a winding up of a Friendly Society. Paragraph 69 of Schedule 10 to the Friendly Societies Act 1992 provides that rules may be made under section 411 of the Insolvency Act 1986 for the purpose of giving effect to winding up legislation in relation to Friendly Societies. No such rules have been made. Given that the intention would appear to be for special rules to apply (as opposed to the Insolvency Rules 1986, which apply to English Companies), there would appear to be no applicable rules currently, and therefore there is no equivalent for Friendly Societies of Rule 4.90 of the Insolvency Rules 1986, which is the insolvency set-off provision applicable to English Companies.

No official explanation for this state of affairs has ever been given. This unsatisfactory state of affairs in relation to Friendly Societies (and Building Society insolvency proceedings other than under the

294 Section 20 of the Friendly Societies Act 1992 contemplates dissolution by consent of its members, but this would have no impact on existing contractual obligations of the Friendly Society and would therefore occur only on a solvent basis, after agreement between the Friendly Society and the other party to terminate the relevant contract on an agreed basis or following completion of one of the insolvency procedures mentioned in this Annex 6. Section 25 of the Friendly Societies Act 1992 gives the court the power to declare the dissolution of a Friendly Society void on an application by, among others, "any ... person appearing to the Court to be interested", which would certainly include a creditor of the friendly society. A Friendly Society that is in the course of dissolution by consent may be wound up by the court under section 22. In our view, therefore, the power of the members to dissolve a Friendly Society by consent under section 20 would not materially affect our conclusions in this memorandum.

Banking Act) was highlighted by the Financial Markets Law Committee in December 2007, but so far the government has taken no action to remedy this lacuna.[295]

It is possible that a Friendly Society could be made subject to a scheme of arrangement under Part 26 of the Companies Act 2006 for the reasons given in Annex 9 in relation to Chartered Corporations. The same arguments as apply in relation to a Chartered Corporation would arguably also apply in relation to a Friendly Society.[296]

1. SECURITY DOCUMENTS

Conclusion

On the basis of the assumptions and subject to the qualifications in this memorandum as modified and supplemented by this Annex 6 and subject to the analysis set out in this Annex 6, we are of the view that the analysis in part III.3 of this memorandum of issues relating to the enforceability of the Security Documents against a Security Collateral Provider would apply in circumstances where the Security Collateral Provider is a Friendly Society, subject to the following:

(a) the Registration Provisions will not apply because a Friendly Society is not an English Company; and

(b) on the basis that the administration provisions in Part II of the Insolvency Act 1986 are not applicable to a Friendly Society, our answers to the questions in part III.3 of this memorandum which relate to administration should be disregarded. The same is true of CVAs (and so, for example, our explanation in the body of this memorandum of the "eligible company" moratorium under the Insolvency Act 2000 is not relevant to a Friendly Society).

2 ENGLISH TRANSFER ANNEX

2.1 Conclusion

On the basis of the assumptions and subject to the qualifications in this memorandum as modified and supplemented by this Annex 6 and subject to the analysis set out in this Annex 6, we are of the view that our conclusions in part IV.3 of this memorandum would apply to a Friendly Society in the event that insolvency proceedings are commenced in England in respect of the Friendly Society.

2.2 Analysis

We believe that the close-out netting provisions of the ISDA Master Agreement would be enforceable against a Friendly Society in the event of its winding up, without reliance on a statutory insolvency set-off rule, for the reasons we give in part III.3(3)(a) of the ISDA Netting Opinion in relation to an English Company on the basis that the close-out netting provisions of the ISDA Master Agreement do not involve contractual set-off (other than to the limited extent that it includes Unpaid Amounts owed by either party that became payable

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295 The Financial Markets Law Committee published a paper in December 2007 entitled "Building Society and Friendly Society Set-off: Proposal for a Mandatory Insolvency Set-off Rule Applicable to Building Societies and Incorporated Friendly Societies", which deals with these issues in some detail. The paper may be found on the FMLC website at http://www.fmlc.org/uploads/2/6/5/8/26584807/118.pdf accessed on 30 December 2015.

296 The key to the argument is the breadth of the word "company" in section 895(2)(b) of the Companies Act 2006, as discussed in Annex 9. It is clear that this is intended to be broader than an English Company. A Friendly Society is a body corporate and the fact that it is a mutual would not exclude it from the scope of the word "company" in that context.

prior to the operation of Section 6(c)(ii) of the ISDA Master Agreement, as discussed in the ISDA Netting Opinion) but simply represent an accounting of rights and liabilities under a single agreement following the designation or deemed occurrence of an Early Termination Date (sometimes referred to as the "flawed asset" approach to close-out netting).

If, however, the court were to construe the close-out netting provisions of the ISDA Master Agreement as operating by way of contractual set-off rather than pursuant to the single agreement (or "flawed asset") approach described above, we also consider that the close-out netting provisions of the ISDA Master Agreement would be enforceable against a Friendly Society. Our reasons for this view are principally those set out in part III.3(3)(a) of the ISDA Netting Opinion in relation to an English Company, supplemented by our view that an English court would find that insolvency set-off applies, despite the fact that there is no statutory insolvency set-off rule for Friendly Societies. We believe this would be the result because it is clear, in our view, that the lack of insolvency rules for Friendly Societies is a failure of administration rather than a deliberate policy choice, much less an expression of the will of Parliament.

The policy reasons in favour of insolvency set-off for Friendly Societies are as strong as they are in relation to individuals or companies, and there is a common law basis for the insolvency set-off provision which pre-dates its first appearance in statutory form in 1705. An English court would therefore, in our view, either find that insolvency set-off applies as a matter of common law in relation to a Friendly Society in winding up or, alternatively, would find that the close-out netting provisions of the ISDA Master Agreement viewed as a form of contractual set-off do not offend against any mandatory rule of English insolvency law and are therefore enforceable in accordance with their terms.

In addition to the arguments above, if the English Transfer Annex forms part of a financial collateral arrangement under the FCA Regulations as discussed in part II above, regulation 12 provides that a close-out netting provision shall, subject to paragraph (2), take effect in accordance with its terms notwithstanding that the collateral-provider or collateral-taker under the arrangement is subject to winding-up proceedings or reorganisation measures.

If a Friendly Society were to enter into a scheme of arrangement under Part 26 of the Companies Act 2006, the close-out netting provisions of the ISDA Master Agreement would be enforceable against the Friendly Society on the same basis as the close-out netting provisions would be enforceable against an English Company, as set out in part III.3(3)(d) of the ISDA Netting Opinion.

Since the English Transfer Annex relies for its effectiveness on the inclusion of the Credit Support Balance within the scope of the close-out netting provisions in Section 6(e) of the ISDA Master Agreement, we are of the view that an English court would find the title transfer collateral arrangement effected by the English Transfer Annex is enforceable against a Friendly Society in the event of insolvency proceedings in respect of it in England.

ANNEX 7

C/CB SOCIETY

In this Annex 7, we set out our views on the enforceability of the Credit Support Documents against a C/CB Society (formerly an Industrial & Provident Society)[297] in the event that insolvency proceedings are commenced in England in respect of the C/CB Society. In this Annex 7 we consider only a C/CB Society that is neither an English Insurance Company nor an English Charity nor otherwise subject to a special regulatory regime (such as a private registered provider of social housing, a registered social landlord or a credit union). In Annex 10 we consider a C/CB Society that is an English Insurance Company, and in Annex 13 we consider a C/CB Society that is an English Charity.

Subject to the more detailed discussion below, the types of insolvency proceeding that may be commenced in England in respect of a C/CB Society are, pursuant to the Co-operative and Community Benefit Societies Act 2014, a voluntary or compulsory winding up under the Insolvency Act 1986, administration, a company voluntary arrangement and a scheme of arrangement under Part 26 of the Companies Act 2006.

Insolvency proceedings in respect of a C/CB Society

Section 123 of the Co-operative and Community Benefit Societies Act 2014 states that a C/CB Society may be dissolved on its being wound up in pursuance of an order or resolution made as is directed in the case of companies registered under the Companies Acts. The provisions relating to the winding up of companies registered under the Companies Acts have effect in relation to a registered society as if the society were such a company. Therefore the provisions of the Insolvency Act 1986 relating to the winding up of companies apply to C/CB Societies, with some minor modifications that are not material to the questions considered in this memorandum[298].

The Co-operative and Community Benefits Societies Act 2014 does not give detailed guidance as to how the companies winding-up regime will apply to a C/CB Society. However Harman J in *Re Norse Self Build Association*[299] held that section 55 of the Industrial and Provident Societies Act 1965 (which was the equivalent section under the previous regime) enabled an Industrial & Provident Society to be wound up in exactly the same way as if it were an English Company and that it is unnecessary to have resort to the power to wind up unregistered companies in Part V of the Insolvency Act 1986. Although the Industrial and Provident Societies Act 1965 has been repealed and replaced by the Co-operative and Community Benefit Societies Act 2014, *Re Norse Self Build Association*[300] would still apply as the relevant sections of the 2014 Act are substantially the same. This means that the Insolvency Rules 1986 as far as they are relevant to a winding up would apply to the winding up of a C/CB Society, including the insolvency set-off provision in Rule 4.90.

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297 The Industrial and Provident Societies Act 1965 has been replaced by the Co-operative and Community Benefit Societies Act 2014, which came into force on 1 August 2014. Sections 1(1)(b) and 150(1) of the Co-operative and Community Benefit Societies Act 2014 deem any reference to societies registered under it to include societies that were, prior to its commencement, registered under the Industrial and Provident Societies Act 1965.

298 Section 119 of the Co-operative and Community Benefit Societies Act 2014 contemplates dissolution by consent of its members. The instrument of dissolution must set forth the claims of creditors and the provision to be made for their payment and this procedure would have no impact on existing contractual obligations of the C/CB Society. It would therefore occur only on a solvent basis, after agreement between the C/CB Society and the other party to terminate the relevant contract on an agreed basis or following completion of one of the insolvency procedures mentioned in this Annex 7. In our view, therefore, the power of the members to dissolve a C/CB Society by consent under section 119 would not materially affect our conclusions in this memorandum.

299 [1985] BCLC 219.

300 [1985] BCLC 219.

The Co-operative and Community Benefit Societies and Credit Unions (Arrangements, Reconstructions and Administration) Order 2014 (formerly the Industrial and Provident Societies and Credit Unions (Arrangements, Reconstructions and Administration) Order 2014)[301] applies, subject to certain modifications, company voluntary arrangements and administration under the Insolvency Act 1986 and schemes of arrangement under Part 26 of the Companies Act 2006 to C/CB Societies (except certain excluded C/CB Societies not relevant to this memorandum).[302]

1. SECURITY DOCUMENTS

Conclusion

On the basis of the assumptions and subject to the qualifications in this memorandum as modified and supplemented by this Annex 7 and subject to the analysis set out in this Annex 7, we are of the view that the analysis in part III.3 of this memorandum of issues relating to the enforceability of the Security Documents against a Security Collateral Provider would apply in circumstances where the Security Collateral Provider is a C/CB Society, subject to the qualification that the Registration Provisions will not apply because a C/CB Society is not an English Company. [303]

2. ENGLISH TRANSFER ANNEX

2.1 Conclusion

On the basis of the assumptions and subject to the qualifications in this memorandum as modified and supplemented by this Annex 7 and subject to the analysis set out in this Annex 7, we are of the view that our conclusions in part IV.3 of this memorandum would apply to a C/CB Society in the event that insolvency proceedings are commenced in England in respect of the C/CB Society.

2.2 Analysis

We are of the view that the close-out netting provisions of the ISDA Master Agreement would be enforceable against a C/CB Society in the event of its winding up or administration for the reasons we give in part III.3(3)(a) and (b) of the ISDA Netting Opinion in relation to an English Company on the basis that the close-out netting provisions of the ISDA Master Agreement do not involve contractual set-off (other than to the limited extent that it includes Unpaid Amounts owed by either party that became payable prior to the operation of Section 6(c)(ii) of the ISDA Master Agreement, as discussed in the ISDA Netting Opinion) but simply represent an accounting of rights and liabilities under a single agreement following the designation or deemed occurrence of an Early Termination Date (sometimes referred to as the "flawed asset" approach to close-out netting).

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301 2014/229.

302 Note that prior to this order, neither administrative receivership nor administration was available in respect of what was then an Industrial & Provident Society. Instead the holder of a floating charge had recourse only to common law receivership. See Snaith, *Handbook of Co-operative and Community Benefit Society Law*, (2nd Edn, Co-operatives UK) 2014. A floating chargeholder in respect of a floating charge created on or prior to 6 April 2014 will continue to have the choice of receivership or administration.

303 We note that there is a provision for the registration of security in section 59 of the Co-operative and Community Benefit Societies Act 2014. Section 59 is not mandatory but successful registration of the security with the FCA has the effect of excluding that security from the provisions of the Bills of Sale Act 1878 (as amended in 1882) requiring security falling within it to be registered within 7 days of creation. However, we are of the view that security in the form of Collateral, on the assumptions we have made in this memorandum, would not fall within the definition of “bills of sale” in the Bills of Sale Act 1878 and therefore registration under the Co-operative and Community Benefit Societies Act 2014 or the Bills of Sale Act 1878 is not mandatory.

If, however, the court were to construe the close-out netting provisions of the ISDA Master Agreement as operating by way of contractual set-off rather than pursuant to the single agreement (or "flawed asset") approach described above, we also consider that the close-out netting provisions of the ISDA Master Agreement would be enforceable against a C/CB Society for the reasons set out in part III.3(3)(a) and (b) of the ISDA Netting Opinion in relation to an English Company.

In addition to the arguments above, if the English Transfer Annex forms part of a financial collateral arrangement under the FCA Regulations as discussed in part II above, regulation 12 provides that a close-out netting provision shall, subject to paragraph (2), take effect in accordance with its terms notwithstanding that the collateral-provider or collateral-taker under the arrangement is subject to winding-up proceedings or reorganisation measures.

If a C/CB Society were to enter into a company voluntary arrangement under the Insolvency Act 1986 or a scheme of arrangement under Part 26 of the Companies Act 2006, the close-out netting provisions of the ISDA Master Agreement would be enforceable against the C/CB Society on the same basis as the close-out netting provisions would be enforceable against an English Company, as set out in part III.3(3)(c) and (d) of the ISDA Netting Opinion.

Since the English Transfer Annex relies for its effectiveness on the inclusion of the Credit Support Balance within the scope of the close-out netting provisions in Section 6(e) of the ISDA Master Agreement, we are of the view that an English court would find the title transfer collateral arrangement effected by the English Transfer Annex is enforceable against a C/CB Society in the event of insolvency proceedings in respect of it in England.

ANNEX 8

STATUTORY CORPORATION

In this Annex 8, we set out our views on the enforceability of the Credit Support Documents against a Statutory Corporation in the event that insolvency proceedings are commenced in England in respect of the Statutory Corporation. In this Annex 8 we consider only a Statutory Corporation that is neither an English Insurance Company nor an English Charity nor otherwise subject to a special regulatory regime. In Annex 10 we consider a Statutory Corporation that is an English Insurance Company and in Annex 13 we consider a Statutory Corporation that is an English Charity.

Subject to the more detailed discussion below, the types of insolvency proceeding that may be commenced in England in respect of a Statutory Corporation established by a private Act of Parliament are a voluntary or compulsory winding up under the Insolvency Act 1986. It is also possible that a Statutory Corporation could be made subject to a scheme of arrangement under Part 26 of the Companies Act 2006.

Insolvency proceedings in respect of a Statutory Corporation

There is good authority for the view that a Statutory Corporation established by a private Act of Parliament may be wound up as an "unregistered company" under section 221 of the Insolvency Act 1986.[304]

Section 221(1) provides that "all of the provisions of this Act about winding up apply to an unregistered company with the exceptions and additions mentioned in the following subsections". Section 221(4) provides that "[n]o unregistered company shall be wound up under this Act voluntarily, except in accordance with the EC Regulation". "EC Regulation" means the EC Insolvency Regulation.[305] Under the EC Insolvency Regulation a company incorporated in an EU member state with its centre of main interests (**COMI**) in England may be wound up in England under a creditors' voluntary winding up.[306] We have defined a Statutory Corporation to be "a body corporate established by private Act of Parliament with its principal place of business in England" and assumed its COMI is in England. As England is part of the United Kingdom, which is an EU member state, a Statutory Corporation may be wound up voluntarily in England. If not wound up voluntarily, a Statutory Corporation will be wound up by the court (compulsory winding up).

Whether the winding up of a Statutory Corporation is conducted on a voluntary or compulsory basis, the provisions of the Insolvency Rules 1986 relevant to a winding up will apply to the winding up of the Statutory Corporation, including the insolvency set-off provision in Rule 4.90.[307]

304 See Derek French, *Applications to Wind Up Companies* (3rd edn, OUP 2015), 34, where numerous cases are cited to support this proposition. Although these cases were decided in relation to the winding up provisions of earlier companies legislation, the same principles appear to us to be applicable in relation to Part V of the Insolvency Act 1986, given the similarity of concepts and terminology in the earlier legislation and the clear intent that these provisions are a consolidation (although amended in certain respects), and therefore a continuation, of the earlier regimes. In support of this approach to these earlier cases, see *Re a Debtor (No 784 of 1991)* [1992] Ch 554, 558-559 (per Hoffmann J); and *Re Modern Jet Support Centre Ltd* [2005] EWHC 1611 (Ch), [2005] 1 WLR 3880 [22], [30]-[31]. See also Len Sealy and David Milman, *Annotated Guide to the Insolvency Legislation 2014*, vol 1 (18th edn, Sweet & Maxwell 2015) page 233.

305 Council Regulation 1346/2000/EC on insolvency proceedings [2000] OJ L160.

306 *Re TXU Europe German Finance BV* [2005] BCC 90.

307 Where a statutory corporation has been established by an Act of Parliament for a public purpose without private shareholders, *obiter dicta* of Denning LJ in the Court of Appeal decision in *Tamlin v Hannaford* [1950] 1 KB 18 provides persuasive support for the view that such a statutory corporation is not liable to be wound up at the suit of any creditor. An earlier case, *Re Exmouth Docks Co.* (1873-1874) LR 17 Eq 181, suggested that a court would be unlikely to make a winding up order in relation to a statutory corporation established for a public purpose under existing legislation. The court was of the view that instead a further Act of Parliament would need to be passed specifically to provide for the winding up. The relationship between the decision in *Exmouth Docks* and the dicta in *Tamlin* is not entirely clear, but together they appear to exclude the possibility of a court's being able to wind up a statutory corporation established for a public purpose without a further Act of Parliament. As a general rule,

A Statutory Corporation may not be made subject to a company voluntary arrangement or to administration proceedings under the Insolvency Act 1986. Each of these regimes is limited to English Companies and certain foreign companies.[308]

It is possible that a Statutory Corporation could be made subject to a scheme of arrangement under Part 26 of the Companies Act 2006 for the reasons given in Annex 9 in relation to a Chartered Corporation. The same arguments as apply in relation to a Chartered Corporation would also apply in relation to a Statutory Corporation.

In relation to any Statutory Corporation, it is possible that the private Act of Parliament under which it is established could provide for its being subject to winding up or some other form of insolvency proceeding, and therefore we advise a party proposing to deal with a Statutory Corporation to check the relevant statute in this regard. For the purposes of this Annex 8, we assume that the relevant statute contains no such provisions or, if it does, we assume that such provisions do not affect our conclusions in this Annex 8.

1. SECURITY DOCUMENTS

On the basis of the assumptions and subject to the qualifications in this memorandum as modified and supplemented by this Annex 8 and subject to the analysis set out in this Annex 8, we are of the view that the analysis in part III.3 of this memorandum of issues relating to the enforceability of the Security Documents against a Security Collateral Provider would apply in circumstances where the Security Collateral Provider is a Statutory Corporation, subject to the following:

(a) the Registration Provisions will not apply because a Statutory Corporation is not an English Company; and

(b) on the basis that the administration provisions in Part II of the Insolvency Act 1986 are not applicable to a Statutory Corporation, our answers to the questions in part III.3 of this memorandum which relate to administration should be disregarded. The same is true of CVAs (and so, for example, our explanation in the body of this memorandum of the "eligible company" moratorium under the Insolvency Act 2000 is not relevant to a Statutory Corporation).

2. ENGLISH TRANSFER ANNEX

2.1 Conclusion

On the basis of the assumptions and subject to the qualifications in this memorandum as modified and supplemented by this Annex 8 and subject to the analysis set out in this Annex 8, we are of the view that our conclusions in part IV.3 of this memorandum would apply to a Statutory Corporation in the event that insolvency proceedings are commenced in England in respect of the Statutory Corporation.

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however, a statutory corporation established for a public purpose is normally established by a public general, rather than private, Act of Parliament and is therefore excluded from the scope of this memorandum. See note 7.

308 In relation to company voluntary arrangements, see the definition of "company" in section 1(4) of the Insolvency Act 1986, and in relation to administration proceedings, see the definition of "company" in paragraph 111(1A) of Schedule B1 to the Insolvency Act 1986.

2.2 Analysis

If a Statutory Corporation established by a private Act of Parliament were wound up as an "unregistered company" under section 221 of the Insolvency Act 1986, then, in our view, the close-out netting provisions of the ISDA Master Agreement would be enforceable against that Statutory Corporation for the reasons we give in part III.3(3)(a) of the ISDA Netting Opinion in relation to an English Company on the basis that the close-out netting provisions of the ISDA Master Agreement do not involve contractual set-off (other than to the limited extent that it includes Unpaid Amounts owed by either party that became payable prior to the operation of Section 6(c)(ii) of the ISDA Master Agreement, as discussed in the ISDA Netting Opinion) but simply represent an accounting of rights and liabilities under a single agreement following the designation or deemed occurrence of an Early Termination Date (sometimes referred to as the "flawed asset" approach to close-out netting).

If, however, the court were to construe the close-out netting provisions of the ISDA Master Agreement as operating by way of contractual set-off rather than pursuant to the single agreement (or "flawed asset") approach described above, we also consider that the close-out netting provisions of the ISDA Master Agreement would be enforceable against the Statutory Corporation for the reasons set out in part III.3(3)(a) of the ISDA Netting Opinion in relation to an English Company.

In addition to the arguments above, if the English Transfer Annex forms part of a financial collateral arrangement under the FCA Regulations as discussed in part II above, regulation 12 provides that a close-out netting provision shall, subject to paragraph (2), take effect in accordance with its terms notwithstanding that the collateral-provider or collateral-taker under the arrangement is subject to winding-up proceedings or reorganisation measures.

If a Statutory Corporation were to enter into a scheme of arrangement under Part 26 of the Companies Act 2006, the close-out netting provisions of the ISDA Master Agreement would be enforceable against the Statutory Corporation on the same basis as the close-out netting provisions would be enforceable against an English Company, as set out in part III.3(3)(d) of the ISDA Netting Opinion.

Since the English Transfer Annex relies for its effectiveness on the inclusion of the Credit Support Balance within the scope of the close-out netting provisions in Section 6(e) of the ISDA Master Agreement, we are of the view that an English court would find the title transfer collateral arrangement effected by the English Transfer Annex is enforceable against a Statutory Corporation in the event of insolvency proceedings in respect of it in England.

ANNEX 9

CHARTERED CORPORATION

In this Annex 9, we set out our views on the enforceability of the Credit Support Documents against a Chartered Corporation in the event that insolvency proceedings are commenced in England in respect of the Chartered Corporation. In this Annex 9 we consider only a Chartered Corporation that is neither an English Insurance Company nor an English Charity nor otherwise subject to a special regulatory regime. In Annex 10 we consider a Chartered Corporation that is an English Insurance Company, and in Annex 13 we consider a Chartered Corporation that is an English Charity.

Subject to the more detailed discussion below, the types of insolvency proceeding that may be commenced in England in respect of a Chartered Corporation are a voluntary or compulsory winding up under the Insolvency Act 1986. It is also possible that a Chartered Corporation could be made subject to a scheme of arrangement under Part 26 of the Companies Act 2006.

Insolvency proceedings in respect of a Chartered Corporation

Winding up of a Chartered Corporation

There is good authority for the view that a Chartered Corporation may be wound up as an "unregistered company" under section 221 of the Insolvency Act 1986.[309]

Section 221(1) provides that "all of the provisions of this Act about winding up apply to an unregistered company with the exceptions and additions mentioned in the following subsections". For the reasons given in relation to a Statutory Corporation in Annex 8 and on the basis of our definition of a Chartered Corporation ("a body corporate established by royal charter granted by the Crown with its principal place of business in England"), in our view a Chartered Corporation may be subject to voluntary or compulsory winding up under the Insolvency Act 1986.

Whether the winding up of a Chartered Corporation is conducted on a voluntary or compulsory basis, the provisions of the Insolvency Rules 1986 relevant to a winding up will apply to the winding up of the Chartered Corporation, including the insolvency set-off provision in Rule 4.90.

Scheme of Arrangement

It appears that a chartered corporation may be made subject to a scheme of arrangement under Part 26 of the Companies Act 2006 (sections 895 to 901).[310]

309 *Re Oriental Bank Corporation* (1885) 54 LJ Ch 481 (CA); *Re Commercial Buildings Co of Dublin* [1938] IR 477. The latter is an Irish case, but it was decided in relation to a corporation established by a royal charter granted on 1 January 1798 with regard to the winding up provisions of the Companies (Consolidation) Act 1908, which at that time applied both in England and Ireland. Although the Irish judge was somewhat sceptical about the basis of the earlier decision in *Re Oriental Bank Corporation*, which was decided by reference to the winding up provisions of the Joint Stock Companies Winding-up Act 1848, he was unequivocal that a chartered corporation could be wound up under the winding up provisions of the 1908 Act. In *Re English, Scottish and Australian Chartered Bank* [1893] 3 Ch 385 (CA) 405, the Court of Appeal considered various issues arising out of a proposed scheme of arrangement in connection with the winding up of the English, Scottish and Australian Chartered Bank, a chartered corporation, the principal business of which was in Australia. It was taken for granted by the Court of Appeal, and not an issue in dispute between the parties, that the High Court had the power to order the winding up of the bank. Derek French (*op cit* note 304) refers to other cases that are similarly concerned with later proceedings in relation to a chartered company that was already in winding up.

310 In *Re English, Scottish and Australian Chartered Bank* [1893] 3 Ch 385, the Court of Appeal upheld an order of the High Court provisionally sanctioning a scheme of arrangement in relation to a bank incorporated by royal charter that was in the course of being wound up.

"Company" for purposes of Part 26 is defined in section 895 of the Companies Act 2006 to include "any company liable to be wound up under the Insolvency Act 1986". In our view, this would include an unregistered company liable to be wound up under section 221 of the Insolvency Act 1986.

This view is supported by an analysis of the whole definition of "company" in section 895:

"'company' –

(a) in section 900 (powers of court to facilitate reconstruction or amalgamation) means a company within the meaning of this Act, and

(b) elsewhere in this Part means any company liable to be wound up under the Insolvency Act 1986 (c 45) or the Insolvency Northern Ireland Order 1989 (SI 1989/2405 (NI 19))."

Clause (a) includes all companies registered under the Companies Act 2006. If Part 26 were limited to such companies, then there would be no need for clause (b). That taken with the argument that an unregistered company is liable to be wound up under the Insolvency Act 1986, as noted above, is in our view sufficient to bring a Chartered Corporation within the scope of Part 26.

The fact that the English court still has discretion under section 221 of the Insolvency Act 1986 to decide whether it has the power to assume jurisdiction and, where it does have the power, the discretion whether or not to exercise it in relation to an unregistered company does not, in our view, mean a Chartered Corporation is not "liable" to be wound up under the Insolvency Act 1986. The argument may be weaker in relation to a foreign company where there is an insufficient connection with England such that it is likely that the grounds for jurisdiction set out in section 221(5) would not be made out.

We note that the Unregistered Companies Regulations 2009 do not apply Part 26 to unregistered companies. But nonetheless, for the reasons given above, we believe that, at least in theory, Part 26 could be applied to a Chartered Corporation.

Winding up in connection with royal charter

In relation to any Chartered Corporation, it is possible that the royal charter under which it is established could provide for its winding up in certain circumstances or may otherwise provide for the revocation of the charter or the dissolution of the Chartered Corporation. We therefore advise a party proposing to deal with a Chartered Corporation to check the royal charter (and any related constitutional documents such as any bye-laws or rules made under the royal charter) in this regard. For the purposes of this Annex 9, we assume that the relevant royal charter (or any related constitutional document) contains no such provisions or, if it does, we assume that such provisions do not affect our conclusions in this Annex.

Administration and company voluntary arrangements not applicable

A Chartered Corporation may not be made subject to a company voluntary arrangement or to administration proceedings under the Insolvency Act 1986. Each of these regimes is limited to English Companies and certain foreign companies.

1. SECURITY DOCUMENTS

On the basis of the assumptions and subject to the qualifications in this memorandum as modified and supplemented by this Annex 9 and subject to the analysis set out in this Annex 9, we are of the view that the analysis in part III.3 of this memorandum of issues relating to the enforceability of the Security Documents against a Security Collateral Provider would apply in circumstances where the Security Collateral Provider is a Chartered Corporation, subject to the following:

(a) the Registration Provisions will not apply because a Chartered Corporation is not an English Company; and

(b) on the basis that the administration provisions in Part II of the Insolvency Act 1986 are not applicable to a Chartered Corporation, our answers to the questions in part III.3 of this memorandum which relate to administration should be disregarded. The same is true of CVAs (and so, for example, our explanation in the body of this memorandum of the "eligible company" moratorium under the Insolvency Act 2000 is not relevant to a Chartered Corporation).

2. ENGLISH TRANSFER ANNEX

2.1 Conclusion

On the basis of the assumptions and subject to the qualifications in this memorandum as modified and supplemented by this Annex 9 and subject to the analysis set out in this Annex 9, we are of the view that our conclusions in part IV.3 of this memorandum would apply to a Chartered Corporation in the event that insolvency proceedings are commenced in England in respect of the Chartered Corporation.

2.2 Analysis

If a Chartered Corporation were wound up as an "unregistered company" under section 221 of the Insolvency Act 1986, then, in our view, the close-out netting provisions of the ISDA Master Agreement would be enforceable against that Chartered Corporation for the reasons we give in part III.3(3)(a) of the ISDA Netting Opinion in relation to an English Company on the basis that the close-out netting provisions of the ISDA Master Agreement do not involve contractual set-off (other than to the limited extent that it includes Unpaid Amounts owed by either party that became payable prior to the operation of Section 6(c)(ii) of the ISDA Master Agreement, as discussed in the ISDA Netting Opinion) but simply represent an accounting of rights and liabilities under a single agreement following the designation or deemed occurrence of an Early Termination Date (sometimes referred to as the "flawed asset" approach to close-out netting).

If, however, the court were to construe the close-out netting provisions of the ISDA Master Agreement as operating by way of contractual set-off rather than pursuant to the single agreement (or "flawed asset") approach described above, we also consider that the close-out netting provisions of the ISDA Master Agreement would be enforceable against the Chartered Corporation for the reasons set out in part III.3(3)(a) of the ISDA Netting Opinion in relation to an English Company.

In addition to the arguments above, if the English Transfer Annex forms part of a financial collateral arrangement under the FCA Regulations as discussed in part II above, regulation 12 provides that a close-out netting provision shall, subject to paragraph (2), take effect in accordance with its terms notwithstanding that the collateral-provider or collateral-taker under the arrangement is subject to winding-up proceedings or reorganisation measures.

If a Chartered Corporation were to enter into a scheme of arrangement under Part 26 of the Companies Act 2006, the close-out netting provisions of the ISDA Master Agreement would be enforceable against the Chartered Corporation on the same basis as the close-out netting provisions would be enforceable against an English Company, as set out in part III.3(3)(d) of the ISDA Netting Opinion.

Since the English Transfer Annex relies for its effectiveness on the inclusion of the Credit Support Balance within the scope of the close-out netting provisions in Section 6(e) of the ISDA Master Agreement, we are of the view that an English court would find the title transfer collateral arrangement effected by the English Transfer Annex is enforceable against a Chartered Corporation in the event of insolvency proceedings in respect of it in England.

ANNEX 10

ENGLISH INSURANCE COMPANY

In this Annex 10, we set out our views on the enforceability of the Credit Support Documents against an English Insurance Company in the event that insolvency proceedings are commenced in England in respect of the English Insurance Company.

The types of insolvency proceeding that may be commenced in England in respect of an English Insurance Company depend on the legal form in which it is established as well as specific insolvency rules applicable to an English Insurance Company as discussed below in this Annex 10.

A summary of the types of insolvency proceedings that may be commenced in England is set out, in respect of:

(a) an English Company, in part III.1(4) of the ISDA Netting Opinion;

(b) a Friendly Society, in Annex 6;

(c) a C/CB Society, in Annex 7;

(d) a Statutory Corporation, in Annex 8; and

(e) a Chartered Corporation, in Annex 9.

One of the most important changes made by the specific insolvency rules applicable to insurers is that an English Insurance Company that is a Statutory Corporation or Chartered Corporation can be put into administration proceedings. Normally administration proceedings are not available in relation these legal forms of entity, as noted in Annexes 8 and 9, respectively. Administration proceedings remain unavailable for an English Insurance Company that is a Friendly Society.

As noted in part 1 of this memorandum, an English Insurance Company may be organised in one of a number of different legal forms. The most common forms are the five forms covered by this memorandum. As a general rule the following analysis in this Annex 10 applies to an English Insurance Company regardless of the form in which it is established, but there are some points regarding which the analysis is affected by the relevant form of organisation. These points are noted below.

There are a number of provisions of English law that apply differently to English Insurance Companies than they do to other companies established in the United Kingdom. There are also some differences between the provisions applicable to mutual and proprietary English Insurance Companies, and between English Insurance Companies carrying on direct insurance business and reinsurance business, but these are less significant. We highlight relevant differences below.

So far as this advice is concerned, the legal provisions that are likely to be relevant are:

(1) the specific insolvency rules applicable to English Insurance Companies, which modify the insolvency regimes that would normally apply; and

(2) the rules governing the financial regulation of English Insurance Companies (which in turn account for certain particular features of the insolvency rules, as described below).

The legal framework for insurance regulation in the United Kingdom is currently set out in the Financial Services and Markets Act 2000 together with rules and regulations made by the Regulators and the Treasury, under powers conferred by the Financial Services and Markets Act 2000. This regime broadly implements the requirements of the EU life and non-life Insurance Directives.[311] The Regulators publish a Handbook of rules and guidance made pursuant to powers conferred on them under the Financial Services and Markets Act 2000. Of particular relevance is the section of the Handbook entitled "Prudential Sourcebook for Insurers" (**INSPRU**).

The effecting and carrying out of contracts of insurance as principal in the United Kingdom are (subject to minor exclusions) regulated activities for the purposes of the Financial Services and Markets Act 2000,[312] and persons who carry on such activities require authorisation under the Financial Services and Markets Act 2000 and the appropriate permission under Part 4A of the Financial Services and Markets Act 2000 having regard to the regulated activities performed. Authorisation and supervisory powers are conferred by the Financial Services and Markets Act 2000 on the Regulators, including the power to grant and vary Part 4A permissions. The Financial Services and Markets Act 2000 and rules and regulations made under it together impose a number of requirements on an English Insurance Company that are in addition to the requirements contained in its constitution and the requirements of the Companies Act 2006 or other statute applicable to the specific entity type.

For the purposes of the Financial Services and Markets Act 2000, it is necessary to make a distinction between English Insurance Companies conducting "long-term insurance business" (**Life Insurance Companies**) and those conducting "general insurance business" (**General Insurance Companies**). Long-term insurance business would include, for example, life assurance, annuity and pension fund management whereas general insurance business would include what is sometimes known as "non-life" or "property and casualty" business (including, for example, household, vehicle, liability, accident and sickness insurance). There are important differences between the regulatory rules governing long-term insurance business (which includes many savings products) and general insurance business, the former affording, overall, a higher level of policyholder protection.

"Long-term" and "general" insurance business are defined in more detail in the Financial Services and Markets Act 2000 and the Handbook. The Financial Conduct Authority maintains a register of all companies (including, *inter alia*, English Insurance Companies) that are authorised under the Financial Services and Markets Act 2000. This register states what class or classes of business (long-term or general and the sub-divisions thereof) each English Insurance Company may carry on.

Some English Insurance Companies (**Composites**) have permission to carry on both long-term and general insurance business. However, pursuant to the EU Consolidated Life Directive, an English Insurance Company will now, with certain exceptions, not be given permission to do so.[313] The main exceptions are for a few older English Insurance Companies established before 15 March 1979 and for pure reinsurers (to which the Directive does not apply).

Composites must maintain separate funds for their long-term and general insurance businesses and may not use assets of the long-term business to fund the general business. Therefore, when dealing with a Composite, it is particularly important for a party to know whether it is dealing with it in relation to its long-term business or its general business. If it is dealing with the Composite in relation to each business, it should have a separate ISDA Master Agreement (and, where applicable, Credit Support Document) for each and take particular care to ensure that each Transaction with that English Insurance Company is allocated to the correct ISDA Master Agreement for the business to which that

311 Consolidated Life Directive 2002/83/EC; First, Second and Third Council Non-Life Directives (73/239/EEC, 88/357/EEC and 92/49/EEC), as amended by 2002/13/EC. The Reinsurance Directive 2005/68/EC, a modified version of the life and non-life Insurance Directives, applies to pure reinsurers (that is, insurers which only carry on reinsurance business).

312 Financial Services & Markets Act 2000 (Regulated Activities) Order 2001 SI 2001/544, art 10. In the Handbook, the business of effecting or carrying out contracts of insurance as principal is known as "insurance business".

313 See INSPRU 1.5.17.

Transaction relates. The party should therefore obtain from the Composite in relation to each Transaction, to be included in the relevant Confirmation, a specific representation as to the business to which the Transaction relates.

We assume for the purposes of the analysis in this Annex 10 that all Transactions (including that represented by the English Transfer Annex) between a party and an English Insurance Company under the ISDA Master Agreement are entered into for the purposes of either (a) the long-term insurance business of the English Insurance Company (in the case of an English Insurance Company that carries on long-term business) or (b) its other businesses (if any), and not a mixture of both.

Modifications of general insolvency law in relation to an English Insurance Company

Subject to certain modifications mentioned below, the winding up in England of an English Insurance Company is governed by the rules that would apply according to its legal form. Although there are various differences of detail in the winding up regimes that would apply to each form of English Insurance Company, each form is broadly subject to the winding up regime applicable to an English Company.

For all forms of English Insurance Company apart from a Friendly Society, this includes the application of the Insolvency Rules 1986 relevant to winding up, including the insolvency set-off provision in Rule 4.90. Although the Insolvency Rules 1986 would not apply in the winding up of an English Insurance Company that is a Friendly Society, we believe that a court would, to give proper effect to the winding up regime applicable to Friendly Societies, find that insolvency set-off applies, as discussed in more detail in Annex 6.

Accordingly, in contrasting the winding up regime that would normally apply to each of the five legal forms of entity within the scope of this memorandum with the winding up regime applicable to an English Insurance Company, we primarily refer below to the regime applicable to an English Company. None of the differences of detail in relation to the other four winding up regimes affects our conclusions in this Annex 10.

The insolvency regime applicable to each form of English Insurance Company other than an English Insurance Company that only carries on reinsurance business (a **pure reinsurer**) is subject to certain provisions of the Insurers (Reorganisation and Winding Up) Regulations 2004 (the **RWU Regulations**).[314]

In addition, the insolvency regime applicable to an English Insurance Company other than one established as a Friendly Society[315] is subject to:

(i) Part XXIV (sections 355 – 379) of the Financial Services and Markets Act 2000;

(ii) the Insurers (Winding Up) Rules 2001 (the **Winding Up Rules**),[316] made under section 379 of the Financial Services and Markets Act 2000; and

314 SI 2004/353.

315 Part XXIV of the Financial Services and Markets Act 2000 includes various provisions relating to insolvency of authorised persons. In relation to English Insurance Companies, its provisions are limited to an "insurer". Under s 355 of the Financial Services and Markets Act 2000 the term "insurer" has such meaning as may be specified in an order made by the Treasury. The Treasury made such an order in the form of the Financial Services and Markets Act 2000 (Insolvency) (Definition of "Insurer") Order 2001 SI 2001/2634. Article 2 of that Order provides as follows: "In Part XXIV of the Act (insolvency), 'insurer' means any person who is carrying on a regulated activity of the kind specified by article 10(1) or (2) of the Regulated Activities Order (effecting and carrying out contracts of insurance) but who is not – (a) exempt from the general prohibition in respect of that regulated activity; (b) a friendly society; or (c) a person who effects or carries out contracts of insurance all of which fall within paragraphs 14 to 18 of Part I of Schedule 1 to the Regulated Activities Order in the course of, or for the purposes of, a banking business." An English Insurance Company established as a Friendly Society would therefore not fall within this definition. The four other legal forms of English Insurance Company covered by this memorandum would fall within this definition.

316 SI 2001/3635.

(iii) the Financial Services and Markets Act 2000 (Administration Orders Relating to Insurers) Order 2010 (the **Insurer Administration Order**),[317] made under section 360 of the Financial Services and Markets Act 2000.

The main modifications made by these instruments to the general rules are discussed below.

(a) Administration

Section 360 of the Financial Services and Markets Act 2000 empowers the Treasury by statutory order to apply the administration provisions of the Insolvency Act 1986 to English Insurance Companies, other than an English Insurance Company established as a Friendly Society,[318] subject to any specified modifications.

Pursuant to the Insurer Administration Order, an English Insurance Company, other than a Friendly Society, is subject to the administration provisions in Schedule B1 to the Insolvency Act 1986, but such an administration must be commenced by order of the court. Appointment of an administrator out of court (that is, by filing prescribed documents with the court) is not possible in relation to an English Insurance Company. The basic time limit for the duration of an administration is extended from 12 to 30 months.

Pursuant to the Insurer Administration Order, as from 1 February 2011, rules equivalent to those already in place in respect of the winding up of Life Insurance Companies and Composites under section 379 of the Financial Services and Markets Act 2000 became applicable to the administration of Life Insurance Companies and Composites.[319] A statutory duty is imposed upon the administrator to carry on the long-term insurance business (unless the court otherwise orders) with a view to it being transferred to another company as a going concern.

(b) Priority of claims

There are important differences in the priority of claims against an English Insurance Company in liquidation compared to an English Company in liquidation. Creditors of an English Company rank in the following (descending) order of priority:

(A) realisations from assets subject to fixed charges paid to the fixed charge holder;

(B) the expenses of the insolvency practitioner (including remuneration);[320]

(C) preferential creditors (discussed further below);

317 SI 2010/3023.

318 See note 315.

319 Article 3 of the Insurer Administration Order applies the Insolvency Rules 1986 so far as they give effect to administration to relevant insurers.

320 Section 176ZA of the Insolvency Act 1986 (introduced by section 1282 of the Companies Act 2006) and Rule 4.218 of the Insolvency Rules 1986 (introduced by The Insolvency (Amendment) Rules 2008 SI 2008/737) provide that the expenses of a winding up in England and Wales are payable out of the assets of the company available for payment to general creditors and, subject to Rules 4.218A to 4.218E of the Insolvency Rules 1986, out of the property comprised in or subject to a floating charge created by the company. Rules 4.218A to Rule 4.218E set out a reasonably detailed set of rules intended to protect the holder of a floating charge from erosion of its security by requiring that a liquidator obtain (a) the holder's approval or authorisation of the amount of any liquidation expenses to be incurred by the liquidator in relation to legal proceedings for the purpose of preserving, realising or getting in any of the assets of the company or (b) in certain circumstances, for example, where the holder is the proposed defendant in the legal proceedings, the consent of the court.

(D) unsecured creditors to the extent of the "prescribed part" (discussed further below);

(E) the floating charge holder (to the extent of the charge); and

(F) unsecured senior (unsubordinated) creditors.

Preferential debts rank equally with each other. They include:

(i) occupational pension scheme contributions and state scheme premiums; and

(ii) remuneration of employees.

The preferential status previously afforded to debts owed to the Crown by an insolvent company was abolished as a consequence of the introduction of the Enterprise Act 2002 on 15 September 2003. Accordingly, money owed to HM Revenue & Customs for income tax deducted at source, value-added tax, betting and gaming duties and social security contributions now rank as ordinary unsecured claims.

The Enterprise Act 2002 also created a priority for unsecured creditors. Section 176A of the Insolvency Act provides that any receiver (including an administrative receiver), liquidator or administrator of a company is required to make a "prescribed part" of the floating charge realisations available for the satisfaction of unsecured debts in priority to the claims of the floating charge holder. This obligation does not apply if the floating charge realisations are less than a prescribed minimum and the relevant officeholder is of the view that the cost of making a distribution to unsecured creditors would be disproportionate to the benefits. The relevant officeholder may also apply to court for an order that the provisions of section 176A should not apply on the basis that the cost of making a distribution would be disproportionate to the benefits. The "prescribed part" is defined in the Insolvency Act 1986 (Prescribed Part) Order 2003 to be an amount equal to 50 per cent. of the first £10,000 of floating charge realisations plus 20 per cent. of the floating charge realisations thereafter, provided that such amount may not exceed £600,000. Section 176A applies to any floating charge granted on or after 15 September 2003.

In the case of an insolvent English Insurance Company (whether carrying on life or non-life or direct or reinsurance business and whether mutual or proprietary), the application of the above rules would mean that, generally speaking, the claims of its policyholders would rank equally with those of general unsecured and unsubordinated creditors in the case of a winding up or, where applicable, an administration of the English Insurance Company.

However, the position is considerably altered as regards direct insurance undertakings (that is, not pure reinsurers) by the RWU Regulations, which give effect in the United Kingdom to the Reorganisation and Winding-up of Insurance Undertakings Directive 2001/17/EC (the **Insurance Winding Up Directive**). As noted in our answer to question 20 in part III, the EC Insolvency Regulation does not apply to English Insurance Companies.

The Insurance Winding Up Directive applies in respect of direct insurance undertakings (not pure reinsurers) which have their head office or (if the undertaking's head office is situated in a third country) a branch within the European Economic Area (**EEA**). It confers exclusive jurisdiction over the reorganisation and winding up of direct insurance undertakings on the courts or other competent authorities of the EEA member state in which the head office or branch is situated, and provides for the decisions of those authorities to be recognised throughout the EEA.

Although for the most part the domestic rules applicable in the EEA member state of the head office or branch of the insurance undertaking will apply to a reorganisation or winding up, this is subject to some qualifications. In particular, EEA member states are required to introduce one of two systems of priority:

(i) direct insurance claims (that is, not reinsurance claims) must, with respect to assets representing the technical provisions (that is, assets set aside to cover liabilities to policyholders), take absolute precedence over any other claim on the undertaking; or

(ii) direct insurance claims must, with respect to the whole of the undertaking's assets, take precedence over any other claim on the insurance undertaking with the only possible exception of:

 (A) claims by employees arising from employment contracts and employment relationships;

 (B) claims by public bodies on taxes;

 (C) claims by social security systems; and

 (D) claims on assets subject to "rights in rem".

Whichever system is chosen, precedence may also be given to the whole or part of the winding-up expenses.

The RWU Regulations adopt option (ii) above, so that:

(1) preferential debts, as described above and as amended by the Enterprise Act 2002, have priority over direct insurance claims; and

(2) secured debts and proprietary rights are not affected by the winding up provided that they are treated as "rights in rem" for the purposes of the Insurance Winding Up Directive. The term "rights in rem" is not defined in the Insurance Winding Up Directive or in the RWU Regulations, but we consider that it will cover most, if not all, proprietary rights currently recognised by English law.

The priority afforded to direct insurance claims is also preserved in respect of the "prescribed part" of the floating charge realisations that a receiver (including an administrative receiver), liquidator or administrator of a company is required to make available for the satisfaction of unsecured debts in priority to the claims of the floating charge holder.[321] The RWU Regulations provide that such direct insurance debts must be paid out of the prescribed part in priority to all other unsecured claims.

Accordingly, in the case of a winding-up[322] of an English Insurance Company, unsecured senior creditors of the English Insurance Company rank equally with each other but behind other creditors in the following (descending) order of priority:

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321 The prescribed part is to be reserved pursuant to section 176A of the Insolvency Act 1986. Please refer to the discussion above on section 176A where the circumstances in which the prescribed part must be reserved are described.

322 Presently if an administrator of an English Insurance Company makes a distribution to creditors under paragraph 65 of Schedule B1 to the Insolvency Act 1986, the RWU Regulations do not specifically provide that he or she should give priority to direct insurance claims. The special priority to direct insurance claims only applies in the case of the winding-up of an Insurance Company or if an administrator of an English Insurance Company makes a distribution under the powers conferred by Schedule 1 to the Insolvency Act (see the Schedule to the Insurer Administration Order). However, paragraph 65 of Schedule B1 to the Insolvency Act 1986 provides that section 175 of the Insolvency Act 1986 (which governs preferential debts) applies in an administration as it applies in a winding-up. As section 175 of the Insolvency Act 1986 is disapplied by the RWU Regulations in

(i) in relation to realisations of assets subject to a floating charge:

(A) the expenses of the winding up (including the liquidator's remuneration);

(B) preferential creditors (discussed above);

(C) unsecured creditors to the extent of the prescribed part, with creditors with direct insurance claims taking priority over other unsecured creditors in respect of the prescribed part;

(D) the floating charge holder (to the extent of the charge);

(E) creditors with direct insurance claims (to the extent not fully satisfied under (C) above); and

(ii) in relation to realisations of unsecured assets:

(A) the expenses of the winding up (including the liquidator's remuneration);

(B) preferential creditors;

(C) creditors with direct insurance claims.

As in the case of a holder of a fixed charge granted by an English Company, the holder of a fixed charge granted by an English Insurance Company (such as under a Security Document, subject to the discussion in relation to the characterisation thereof in this memorandum) will be paid in priority to all of the above claims to the extent of the holder's security over those assets under the fixed charge.

The RWU Regulations provide expressly that insolvency proceedings in respect of an English Insurance Company will be governed by general English insolvency law, subject to modification by the RWU Regulations.[323] The RWU Regulations do not modify the insolvency set-off provisions applicable in a winding up and, where applicable, an administration, which therefore apply in the winding up or, as the case may be, administration of an English Insurance Company (except in respect of a Friendly Society for the reasons given in Annex 6).

Liquidation expenses, preferential claims and direct insurance claims will rank ahead of the claims of general unsecured creditors (where those unsecured claims are not preferential) after the exercise of any rights of set-off. An unsecured net amount owed by an English Insurance Company under an ISDA Master Agreement will not be a preferential debt under the RWU Regulations. Therefore a party to an ISDA Master Agreement with an English Insurance Company will rank behind preferential debts and, more importantly, behind direct insurance claims.

(c) <u>Composites</u>

The special priority afforded to direct insurance claims detailed in (b) above[324] also applies to Composites which are direct insurance undertakings. In addition, the RWU Regulations

a winding-up, and is replaced with the priority provisions in the RWU Regulations, it is arguable that the priority rules in the RWU Regulations will apply in an administration. Amendment legislation may be required to clarify the position.

323 RWU Regulations, reg 8.

324 Both the priority over unsecured creditors generally, and the priority over unsecured creditors in respect of any prescribed part preserved pursuant to section 176A of the Insolvency Act 1986.

make provision, in the case of such an undertaking which is a "non-transferring" Composite (that is, a Composite the long-term business of which has not been, and is not to be, transferred as a going concern to a person who may lawfully carry out those contracts, in accordance with section 376(2) of the Financial Services and Markets Act 2000), for the separate application of long-term and general business assets in a winding-up to the payment of preferential debts and direct insurance liabilities, as discussed further below.

The result is that in the case of any winding up of a non-transferring Composite on or after 20 April 2003 (or at least one which carries on direct insurance business, as the position as regards a Composite which is a pure reinsurer is unclear), the long-term and general business assets must be applied in discharge, respectively, of the long-term and general business preferential and insurance liabilities, any excess of the long-term assets being applied to meet a deficit in the general business preferential and insurance liabilities and vice versa.[325]

It should also be noted that INSPRU 1.5.30 requires an English Insurance Company to apply assets held in respect of its long term business only for the purposes of that long term business. Furthermore INSPRU 1.5.31 prevents an English Insurance Company from agreeing to or allowing any mortgage or charge on its long term assets other than in respect of a long term liability.

The definition of preferential debts has also been extended to include any winding-up expenses apportioned to either the long-term assets or general business assets so that these expenses will be discharged out of the respective funds. It is not entirely clear whether a liquidator is obliged to discharge unsecured creditors not falling within the category of preferential or insurance liabilities from the separate funds of long-term business assets and general business assets.[326]

Accordingly, it is our view that, on the winding up of a non-transferring Composite, it may not be possible to net Transactions (including that represented by the English Transfer Annex) entered into in connection with the English Insurance Company's long-term business against Transactions entered into in connection with its general business and such mingling of Transactions should be avoided.

The same is true of any attempt to give security (for example, under a Security Document) over assets relating to the English Insurance Company's long-term business to secure liabilities entered into in connection with its general business.

(d) Winding-up restrictions (Life Insurance Companies)

Each form of English Insurance Company may be wound up voluntarily under the Insolvency Act 1986. However, in the case of a Life Insurance Company or Composite, section 366(1) of the Financial Services and Markets Act 2000 requires that the PRA's consent is obtained before such voluntary liquidation is commenced.

Also, on the insolvency of a Life Insurance Company or Composite, a statutory duty under section 376(2) of the Financial Services and Markets Act 2000 is imposed upon the liquidator to carry on its long-term insurance business (unless the court otherwise orders) with a view to

325 An amendment to the RWU Regulations made by reg 2(4) of the Insurers (Reorganisation and Winding Up) (Amendment) Regulations 2004 SI 2004/546 clarified that the preferential debts should be paid after the expenses of the winding up. However, the amendment was not made to the equivalent provision applying to non-transferring Composites. We consider this is likely to be an oversight in the drafting rather than a substantive change to the law.

326 There are some provisions in the RWU Regulations which suggest this may have been the intention. For example, refer to regulations 28(3) and 28(4) of the RWU Regulations relating to proofs of debt lodged by creditors.

it being transferred to another company as a going concern. In practice, as discussed further below, this will usually result in a transfer of business under Part VII of the Financial Services and Markets Act 2000 or some form of arrangement being made between the liquidator and the unsecured creditors in respect of the long-term business of the insolvent English Insurance Company.

The provisions in sections 366(1) and 376(2) are intended to protect the legitimate interests of policyholders rather than non-insurance creditors, however we do not believe that either of the provisions in section 366(1) and 376(2) would prevent, or confer a power on the PRA to prevent, the exercise by a Non-defaulting Party of its rights under the close-out netting provisions (including the application of the English Transfer Annex) of the ISDA Master Agreement or otherwise prejudice the rights of a Secured Party under a Security Document.

(e) Schemes of arrangement

Each form of English Insurance Company may, at least in theory, be made subject to a scheme of arrangement under Part 26 of the Companies Act 2006. In recent years the insolvency of General Insurance Companies with substantial long tail liabilities (that is, liabilities such as those arising from asbestosis which emerge over a long period) have typically been resolved through a scheme of arrangement under section 425 of the Companies Act 1985 under which liabilities were commuted, or part paid as the assets (including reinsurance recoveries) accrue, rather than by a winding up. A smaller number of schemes have also been drawn up for Life Insurance Companies.

The Companies Act 2006 scheme of arrangement provisions are, for present purposes, broadly the same as those in the Companies Act 1985.[327]

The RWU Regulations do not directly apply to such schemes. However, in *Marconi Corporation plc v Marconi plc*,[328] Lindsay J observed that "where the scheme is in practical terms an alternative to a liquidation or administration, it is not wrong… to bear in mind, in the composition of classes of creditors, how the respective creditors would have been treated in the alternative insolvency". The priority rules laid down in the RWU Regulations for liquidations may therefore have an indirect impact on distributions though schemes. Prior to the RWU Regulations coming fully into force, this point was alluded to by Lloyd J in *Re Pan Atlantic Insurance Company Limited*[329] where he suggested that, although not relevant in that case ("as it is not clear that there are any creditors who are not insurance creditors"), the introduction of the RWU Regulations would have to be taken into account in relation to insurance companies with insurance and non-insurance creditors for purposes of composing classes of creditors for the scheme.[330]

A Non-defaulting Party will generally have sufficient time, following notice of the meeting of creditors to consider the scheme, to exercise its rights under the close-out netting provisions of the ISDA Master Agreement, before the scheme is approved by a specified majority of the creditors (or relevant class of creditors) and sanctioned by the court, in accordance with the requirements of the Companies Act 2006, and becomes binding on all the creditors, at least

327 As far as we are aware, to date there has been only one scheme of arrangement for an Insurance Company under Part 26 of the Companies Act 2006, which is a solvent scheme of arrangement for The Scottish Lion Insurance Company Limited. The explanatory statement for the scheme, which is required by section 897 of the Companies Act 2006, was issued on 22 December 2008.

328 [2003] EWHC 663 (Ch)

329 [2003] EWHC 1969 (Ch), [2003] BCC 847

330 In the *Pan Atlantic* case, Lloyd J was asked to consider the potential effect of the 2003 version of the RWU Regulations, which were repealed and replaced by the RWU Regulations in 2004. The differences between the two versions are not relevant to the point under discussion.

where the Non-defaulting Party has a credit monitoring process in place. (It should be noted that there may be some circumstances in which it may be advantageous for a Non-defaulting Party not to close out its position prior to a scheme of arrangement being sanctioned by the court. Professional advice should always be taken when a scheme of arrangement is proposed in this context.)

We do not believe that an English court would sanction a scheme of arrangement that would prejudice non-insurance creditors. Although the Companies Act 2006 provides no guidance to the court as to what factors should guide its decision whether or not to sanction a scheme of arrangement under Part 26 of the Companies Act 2006, it is clear that the purpose of the court being required to sanction the scheme is to ensure, among other things, that the process is fair to the members of each class.

(f) Company voluntary arrangements

An English Insurance Company that is an English Company or a C/CB Society may enter into a CVA with its creditors under Part I of the Insolvency Act 1986, as an alternative to a scheme of arrangement under Part 26 of the Companies Act 2006. This option is not, however, available to an English Insurance Company organised as a Friendly Society, Statutory Corporation or Chartered Corporation for reasons given in relation to each such type of entity elsewhere in this memorandum.

There are certain differences between the rules applicable to schemes of arrangement under the Companies Act 2006 and CVAs under the Insolvency Act 1986, but they are not material to our conclusions in relation to the issues discussed in Annex 10. CVAs are considered not to be well-adapted for use with an English Insurance Company and are therefore relatively rare in this sector. Although section 1A of the Insolvency Act 1986 provides for a moratorium in relation to certain companies proposing to enter into a CVA, English Insurance Companies are expressly excluded from eligibility for the moratorium.[331]

As in the case of a scheme of arrangement, a Non-defaulting Party will generally have sufficient time, following notice of the meeting of creditors to consider the company voluntary arrangement, to exercise its rights under the close-out netting provisions of the ISDA Master Agreement (including the English Transfer Annex), before the scheme is approved by the specified majority of the creditors as required by the Insolvency Act 1986, at least where the Non-defaulting Party has a credit monitoring process in place. Court sanction is not required, but an aggrieved creditor has a limited right to challenge the company voluntary arrangement if it feels it has been unduly prejudiced or there has been a material irregularity in relation to the company voluntary arrangement.

331 Paragraph 2 of Schedule A1 to the Insolvency Act 1986.

(g) Part VII of the Financial Services and Markets Act 2000

Part VII of the Financial Services and Markets Act 2000 sets out provisions for insurance business transfer schemes.[332] An insurance business transfer scheme is a scheme under which the whole or part of the business of an English Insurance Company may be transferred to another body, subject to certain conditions and exclusions. Part VII applies to any English Insurance Company other than a Friendly Society.[333]

Under section 104 of the Financial Services and Markets Act 2000, an insurance business transfer scheme may be effected only if an order has been made by the court sanctioning the scheme under section 111(1) of the Act. Section 107 of the Act governs the making of an application for an order sanctioning the scheme. The application may be made by the English Insurance Company, the transferee or both. If the court sanctions the scheme by order under section 111(1), then certain other provisions of Part VII apply, including sections 112 and 112A.

Section 112(1)[334] sets out the powers of the court in relation to a business transfer scheme, which may be made by the court in its order under section 111(1) sanctioning the scheme or by any subsequent order, as the court thinks fit. Section 112A provides that any right of a person to terminate, modify, acquire or claim an interest or right to treat an interest or right as terminated or modified in consequence of anything done or likely to be done in connection with a scheme under Part VII is not enforceable until after the court has made its order under section 112(1) and is then enforceable only to the extent permitted by the order.

Section 112(1) gives the court broad powers to make any provision it sees fit to give effect to the transfer and to what is "necessary to secure that the scheme is fully and effectively carried out". In particular the court may provide for the transfer of any property or liabilities of the insurer without any requirement for the consent of any third party.

Accordingly, an order under section 112(1) could in theory prejudice a contracting party to a Credit Support Document. However, we do not believe that an English court would make an order that would (a) prejudice the ability of such party as the Secured Party under a Security Document or the Transferee under an English Transfer Annex to exercise its rights against an English Insurance Company or (b) otherwise materially and adversely affect the rights of such party as Secured Party or Transferee, as the case may be. See also Annex 10 to the ISDA Netting Opinion for the impact on the ISDA Master Agreement.

(h) Reduction of contracts

Section 377 of the Financial Services and Markets Act 2000[335] gives the court the power to reduce the value of one or more of an insolvent English Insurance Company's contracts as an alternative to winding-up. We do not, however, believe that this power has been exercised in any significant number of cases.

Section 377 would not, in any event, appear to prevent, or give a court the power to prevent, the exercise by a party contracting with an English Insurance Company of its rights under a

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332 Part VII of the Financial Services and Markets Act 2000 also deals with banking business transfer schemes, as discussed in Annex 1.

333 Financial Services and Markets Act 2000, s 105(3) excludes a Friendly Society from the scope of Part VII of the Act. Transfers in respect of Friendly Societies are made under the Friendly Societies Act 1992.

334 The remainder of section 112 clarifies and, in certain respects, extends the scope of the court's power under section 112(1).

335 This provision does not apply to a Friendly Society. See note 315.

Credit Support Document. A remote possibility exists that it might be used to reduce the value of a subsequent net claim under the ISDA Master Agreement if owed by the English Insurance Company. We are not aware that the power has ever been exercised in relation to the ISDA Master Agreement or any comparable financial market agreement.

(i) Valuation of policies

The Winding Up Rules[336] make provision as to the method of valuing policies of an English Insurance Company that has gone into liquidation. The resulting values are likely to reflect the amount of the reserves that an English Insurance Company should have established to meet its insurance liabilities as well as the values which would in any event have been placed on the policies under the general insolvency rules. They should therefore facilitate an assessment of the assets likely to be available at any time to meet the claims of general unsecured creditors.

(j) Compensation scheme

Under Part XV of the Financial Services and Markets Act 2000, the FSCS has been established under which eligible persons may be compensated where authorised firms are unable, or are likely to be unable, to satisfy protected claims against them. (In the case of an English Insurance Company, the FSCS may alternatively assist by providing financial assistance to the English Insurance Company concerned or by arranging for the transfer of policies to another English Insurance Company.)

In the case of English Insurance Companies, protected claims are claims arising from risks covered by direct long-term insurance policies and (with certain exceptions) direct general insurance policies; and eligible persons are policyholders under such policies (provided that, in the case of general insurance, they are individuals or partnerships), where the risks or commitments insured under the policies are situated in the UK, or in some cases in the EEA, the Channel Islands or the Isle of Man.

The level of compensation payable by the FSCS differs according to the type of insurance policy concerned: when the insurance is compulsory (for example, third party car insurance), full compensation is paid; for non-compulsory general insurance (for example, home and contents insurance) and for long-term insurance policies, 90 per cent. of the amount of the claim is paid (calculated in accordance with Scheme rules).

The FSCS will normally be subrogated to the claims of policyholders to whom it pays compensation (including, under the RWU Regulations, their priority), so the claims of unsecured general creditors should be unaffected. However, the participation of the FSCS in a winding-up may affect (possibly expedite) the progress of winding-up proceedings to some extent.

The Insurer Administration Order imposes a duty on the administrator of an insurer to assist the FSCS in administering the compensation scheme in relation to contracts of insurance, and in securing continuity of insurance in relation to contracts of long-term insurance.

(k) Banking Act– exclusion of insurers

Although the Banking Act was apparently not intended to apply to English Insurance Companies, any English Insurance Company with permission under Part 4A of the Financial Services and Markets Act 2000 to carry on the regulated activity of accepting deposits falls

336 The Winding Up Rules do not apply to a Friendly Society. See note 315.

within the definition of "bank" in section 2(1) of the Banking Act and is therefore *prima facie* within its scope.[337] In our experience, most English Insurance Companies have permission to accept deposits. Section 2(2)(c) of the Banking Act gives the Treasury the power to exclude a class of institutions from the definition of "bank". The Treasury exercised this power, by an order[338] that came into force on 7 January 2010, to exclude any institution with permission under Part 4A of the Financial Services and Markets Act 2000 to effect or carry out contracts of insurance as principal. Therefore the Banking Act does not apply to any English Insurance Company falling within the scope of this memorandum.

Regulatory provisions

The Regulators enjoy wide powers under the Financial Services and Markets Act 2000 to make rules applicable to authorised firms (including English Insurance Companies) and to supervise their businesses, including power to impose individual requirements on an English Insurance Company where there has been a breach of rules or there is a perceived threat to the interests of its policyholders. While it is unlikely that the Regulators would exercise their powers in such a way as to prejudice directly the interests of non-insurance creditors, it may be that an exercise of their powers could in certain circumstances affect the ability of an English Insurance Company to comply with its obligations under the ISDA Master Agreement or a Credit Support Document, as mentioned below.

(a) <u>Separation of long-term insurance business</u>

The provisions in the RWU Regulations relating to non-transferring Composites which are direct insurance undertakings substantially reflect requirements of the Regulators relating to the ongoing supervision of English Insurance Companies that carry on long-term insurance business. In our view those requirements will continue to apply to an insurer in liquidation or provisional liquidation which is a "transferring insurer", that is, its long-term business being carried on with a view to its being transferred to another company, including in the case of a Composite, in circumstances where the liquidator or provisional liquidator causes the insurer to continue its business prior to such transfer.[339]

Any such English Insurance Company is required, under INSPRU 1.5.23, to maintain an account and separate fund in respect of that business. The receipts of that business (premiums and investment income) and the assets representing those receipts must be carried to and form a fund (known as the "long-term insurance fund") separate from all the other assets of the English Insurance Company. This requirement applies so as to require the assets of the long-term insurance fund to be separated not only from assets employed in the general business (in the case of a Composite, whether transferring or non-transferring) but also (whether or not the English Insurance Company is a Composite) from assets employed for other purposes of the English Insurance Company (commonly referred to as "shareholders' funds").[340]

Furthermore, under INSPRU 1.5.30, the assets of a long-term insurance fund will normally not be available to discharge any claim of a creditor of the English Insurance Company that arises from a Transaction not entered into for the purposes of the long-term insurance

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337 "Bank" is defined in section 2(1) of the Banking Act as "a UK institution which has permission under Part 4A of the Financial Services and Markets Act 2000 to carry on the regulated activity of accepting deposits". A "UK institution" is defined in section 2(3) of the Banking Act as "an institution which is incorporated in, or formed under the law of any part of, the United Kingdom".

338 The Banking Act 2009 (Exclusion of Insurers) Order 2010 SI 2010/35.

339 Where the liquidator or provisional liquidator does not cause the Composite to continue its business, but instead realises the assets to make a distribution to creditors, the RWU Regulations referred to above will apply.

340 The above requirements may continue to apply to a Life Insurance Company or Composite in liquidation or provisional liquidation which is a "transferring insurer", that is, where its long-term insurance business is being carried on with a view to it being transferred to another company.

business. Accordingly, in the case of Transactions with a Life Insurance Company or Composite (whether transferring or non-transferring):

(i) it would be a breach of INSPRU 1.5.30 for an English Insurance Company to permit the netting of Transactions (including that represented by the English Transfer Annex) entered into in connection with the English Insurance Company's long-term insurance business against Transactions entered into in accordance with its other business, and such mingling of Transactions should be avoided; the same would apply as regards granting security over assets pertaining to a long-term insurance fund to secure obligations entered into in connection with its other business; and

(ii) it will normally be desirable to ensure that Transactions and Credit Support Documents are all, in fact, entered into with the English Insurance Company's long-term insurance business, since the preponderance of the English Insurance Company's assets are likely to be held in its long-term insurance fund.

The implication of this is that, in order for the ISDA Master Agreement to be for the purpose of the long-term insurance business, the Transactions to which they relate must also be for such purpose. We think that, provided that the Transactions themselves are legal, valid, binding and enforceable and are being entered into in order to hedge an exposure in relation to the long-term insurance fund, the entry into of the ISDA Master Agreement and any related Credit Support Document could be viewed as for the purpose of the long-term insurance fund to the extent that it supports such Transactions.

Section 138E of the Financial Services and Markets Act 2000 provides that no contravention of a rule made by the Regulators makes any Transaction void or unenforceable. Accordingly, we consider that any breach of INSPRU 1.5.30 would not prevent a party contracting with an English Insurance Company from taking proceedings to enforce the ISDA Master Agreement or related Credit Support Document against the English Insurance Company, including proceedings to enforce the netting provisions in the ISDA Master Agreement. We also consider that such a breach would not prevent the English Insurance Company from taking enforcement proceedings against the other party. It also seems unlikely that the Regulators' supervisory powers could be used so as to affect the validity of an agreement entered into in breach of the rules.

Accordingly, the concern of any potential party contracting with an English Insurance Company as to a breach of the rules is likely to be confined to the possibility that such a breach will result in action by the Regulators which would curtail the income or capitalisation of the English Insurance Company or affect the reputational standing of the English Insurance Company or the other party. However, as a result of the practical implications which any requirements imposed upon the English Insurance Company by the Regulators may have, including any disciplinary action which they might take, as the consequence of a breach of INSPRU 1.5.30, we recommend that a party obtain a representation from the English Insurance Company that each Transaction entered into with the English Insurance Company is for the purposes of its long-term insurance business.

To the extent that a party is dealing with an English Insurance Company that is a Life Insurance Company or Composite that uses assets other than long-term insurance business assets, we recommend that separate ISDA Master Agreements and Credit Support Documents are entered into in relation to the long-term business and the general business. In this way Transactions relating to long-term insurance business are governed by one ISDA Master Agreement and Transactions relating to general business are governed by a separate ISDA Master Agreement. This should minimise the risk that the assets of different funds are mixed and the risk that INSPRU 1.5.30 is breached.

Please note that INSPRU 1.5.30 deals with long-term insurance business assets. It does not apply to any other assets of the relevant English Insurance Company. This means that, to the extent that an English Insurance Company used other assets, INSPRU 1.5.30 would not be relevant to the operation of the ISDA Master Agreement and Credit Support Documents although INSPRU 1.5.13/1.5.13A, discussed below, still would be.

A final point to note is that if a Transaction is not entered into for the purpose of the English Insurance Company's long-term insurance business (which is unlikely for the reasons given above) and consequently there has been a breach of the representation suggested above, then the representation may be of limited value to the other party if the English Insurance Company has, in fact, few assets outside its long-term insurance business fund with which to make good the breach.

(b) <u>Insurance business limitation</u>

INSPRU 1.5.13 and 1.5.13A are designed to inhibit English Insurance Companies from entering into business other than insurance business, due to a concern that any such other business may fail and bring down the insurance business with it.

INSPRU 1.5.13 provides as follows:

"A firm [that is, an insurer] other than a pure reinsurer must not carry on any commercial business other than insurance business[341] and activities directly arising from that business."

INSPRU 1.5.13A then provides that:

"A pure reinsurer must not carry on any business other than the business of reinsurance and related operations."

The scope of INSPRU 1.5.13 and 1.5.13A should be noted as they apply to activities wherever carried on. This means that even if performance under the ISDA Master Agreement occurs outside the United Kingdom, INSPRU 1.5.13 and 1.5.13A will still be relevant.

Two questions arise from this provision. First, would the entering into of derivative transactions and related Credit Support Documents by an English Insurance Company be regarded as an activity "directly arising from" insurance business or, in the case of a pure reinsurer, would it be regarded as a "related operation"? Secondly, if an English Insurance Company enters into derivative transactions in breach of INSPRU 1.5.13 or 1.5.13A, what would be the effect on the transaction and the rights of the other party?

There is no meaning attributed to "directly arising from" in INSPRU. However, it seems to us that the phrase should encompass all activities undertaken by an English Insurance Company for the purposes of enabling it to carry out its obligations under contracts of insurance which it has written and that this will include the investment of funds received in the course of its insurance business. There is strong authority from the taxation field to the effect that the investment of funds received by an English Insurance Company will form part and parcel of its insurance business.[342]

More specifically, support for the view that English Insurance Companies may properly enter into derivative contracts such as the Transactions and related Credit Support Documents in relation to their insurance business is given by INSPRU 3.2. This clearly envisages English

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341 That is, the business of effecting or carrying out contracts of insurance as principal.

342 See *Liverpool and London Globe Insurance Company v Bennett* [1913] AC 610 at 621 (opinion of Lord Mersey).

Insurance Companies entering into derivative contracts and provides guidance on the admissibility of those contracts for regulatory valuation purposes. It does not, however, expressly state that English Insurance Companies can enter into the Transactions, Credit Support Documents or agreements similar to the ISDA Master Agreement.

Based on this, we think that an English Insurance Company could enter into the Credit Support Documents in appropriate circumstances. Broadly, we think that Credit Support Documents would be entered into in appropriate circumstances if the underlying Transactions they relate to are entered into for the purposes of efficient portfolio management or the reduction of investment risk in compliance with the requirements of INSPRU 3.2 in relation to the English Insurance Company's long-term insurance business and are likely to be treated as "directly arising" from its insurance business for the purposes of INSPRU 1.5.13 or as "related operations" for the purposes of INSPRU 1.5.13A.

As discussed under (a) above, section 138E of the Financial Services and Markets Act 2000 provides that a contravention of rules made by the Regulators will not make a Transaction void or unenforceable. Accordingly, we consider that, as in the case of INSPRU 1.5.30, any breach of INSPRU 1.5.13 or 1.5.13A would not prevent the other party from taking proceedings to enforce the ISDA Master Agreement or Credit Support Document against the English Insurance Company, including proceedings to enforce the netting provisions in the ISDA Master Agreement. We also consider that such a breach would not prevent the English Insurance Company from taking enforcement proceedings against the other party. It also seems unlikely that the Regulators' supervisory powers could be used so as to affect the validity of an agreement entered into in breach of the rules.

Accordingly, the concern of any party as to a breach of the rules is likely to be confined to the possibility that such a breach will result in action by the Regulators which would curtail the income or capitalisation of the English Insurance Company or that it may affect the reputational standing of the English Insurance Company or, conceivably, the other party. However, as a result of the practical implications which any requirements imposed upon the English Insurance Company by the Regulators may have, including any disciplinary action which they might take, as the consequence of a breach of INSPRU 1.5.13 or 1.5.13A, we recommend that a party obtain a representation from the English Insurance Company that Transactions entered into with the English Insurance Company constitute activities directly arising from insurance business.

RWU Regulations

Aspects of the RWU Regulations have been discussed in the context of the analysis above. For consistency with other annexes of this memorandum, we note here that, as with the Winding Up Regulations, the RWU Regulations contain a number of derogations to the application of English law in the context of a winding up or reorganisation of a UK insurer that may be relevant when considering the enforceability of the Credit Support Documents. Regulation 41 (Third parties' rights in rem) mentioned above states that a relevant reorganisation or a relevant winding up shall not affect the rights in rem of creditors or third parties in respect of assets belonging to the insurer situated within the territory of an EEA State at the relevant time. Other derogations of potential application to the Credit Support Documents include regulation 43 (Creditor's rights to set off), regulation 44 (Regulated markets), regulation 45 (Detrimental acts pursuant to the law of an EEA State) and regulation 46 (Protection of third party purchasers).

1. SECURITY DOCUMENTS

Conclusion

For the reasons discussed above, for the purposes of our conclusions below we assume that all Transactions between a party and an English Insurance Company under the ISDA Master Agreement are entered into for the purposes of either (i) the long-term insurance business of the English Insurance Company (in the case of an English Insurance Company that carries on long-term business) or (ii) its other businesses (if any), and not a mixture of both.

On the basis of the assumptions and subject to the qualifications in this memorandum as modified and supplemented by this Annex 10 and, where applicable each of Annexes 6, 7, 8 and 9 and subject to the analysis set out in those Annexes, we are of the view that the analysis in part III.3 of this memorandum of issues relating to the enforceability of the Security Documents against a Security Collateral Provider would apply in circumstances where the Security Collateral Provider is an English Insurance Company.

2. ENGLISH TRANSFER ANNEX

Conclusion

We set out below our conclusions in relation to the enforceability of the English Transfer Annex against an English Insurance Company established in any of the legal forms falling within the scope of this memorandum. For the reasons discussed above, for the purposes of our conclusions below we assume that all Transactions between a party and an English Insurance Company under the ISDA Master Agreement are entered into for the purposes of either (i) the long-term insurance business of the English Insurance Company (in the case of an English Insurance Company that carries on long-term business) or (ii) its other businesses (if any), and not a mixture of both.

(a) Winding up

If an English Insurance Company were subject to winding up under the rules that would normally apply to an English Insurance Company established in its relevant legal form, then, in our view, the close-out netting provisions of the ISDA Master Agreement would be enforceable against that English Insurance Company for the reasons we give in part III.3(3)(a) of the ISDA Netting Opinion in relation to an English Company on the basis that the close-out netting provisions of the ISDA Master Agreement do not involve contractual set-off (other than to the limited extent that it includes Unpaid Amounts owed by either party that became payable prior to the operation of Section 6(c)(ii) of the ISDA Master Agreement, as discussed in the ISDA Netting Opinion) but simply represent an accounting of rights and liabilities under a single agreement following the designation or deemed occurrence of an Early Termination Date (sometimes referred to as the "flawed asset" approach to close out netting).

If, however, the court were to construe the close-out netting provisions of the ISDA Master Agreement as operating by way of contractual set-off rather than pursuant to the single agreement (or "flawed asset") approach described above, we also consider that the close-out netting provisions of the ISDA Master Agreement would be enforceable against the English Insurance Company for the reasons set out in part III.3(3)(a) of the ISDA Netting Opinion in relation to an English Company.

(b) Administration

If an English Insurance Company, other than a Friendly Society (which cannot be made subject to administration proceedings), were to enter into administration proceedings, the close-out netting provisions of the ISDA Master Agreement would be enforceable against that English Insurance Company on the same basis as the close-out netting provisions would be enforceable against an English Company, as set out in part III.3(3)(b) of the ISDA Netting Opinion.

(c) Company voluntary arrangement

If an English Insurance Company that is an English Company or a C/CB Society were to enter into a CVA under Part I of the Insolvency Act 1986, the close-out netting provisions of the ISDA Master Agreement would be enforceable against that English Insurance Company on the same basis as the close-out netting provisions would be enforceable against an English Company, as set out in part III.3(3)(c) of the ISDA Netting Opinion.

(d) Scheme of arrangement

If an English Insurance Company were to enter into a scheme of arrangement under Part 26 of the Companies Act 2006, the close-out netting provisions of the ISDA Master Agreement would be enforceable against the English Insurance Company on the same basis as the close-out netting provisions would be enforceable against an English Company, as set out in part III.3(3)(d) of the ISDA Netting Opinion.

(e) Conclusion

Under the English Transfer Annex, the parties to the ISDA Master Agreement transfer Eligible Credit Support or Equivalent Credit Support to each other from time to time based on the net exposure of one party to the other party at the relevant time under the ISDA Master Agreement, typically subject to certain thresholds and adjustments agreed between the parties and specified in the Transfer Annex. If an Early Termination Date is designated by a Non-defaulting Party or deemed to occur under Section 6(a) of the ISDA Master Agreement, then under Paragraph 6 of the Transfer Annex the Credit Support Balance as at the Early Termination Date will be included as an Unpaid Amount in the calculation of the net amount to be paid under the close-out netting provisions. As discussed above (and subject to the qualifications contained in the ISDA Netting Opinion), we believe that the close-out netting provisions are enforceable against an insolvent English Insurance Company.

In addition to the arguments above, if the English Transfer Annex forms part of a financial collateral arrangement under the FCA Regulations as discussed in part II above, regulation 12 provides that a close-out netting provision shall, subject to paragraph (2), take effect in accordance with its terms notwithstanding that the collateral-provider or collateral-taker under the arrangement is subject to winding-up proceedings or reorganisation measures.

Accordingly, on the basis of the assumptions and subject to the qualifications in this memorandum as modified and supplemented by this Annex 10 and, where applicable each of Annexes 6, 7, 8 and 9 and subject to the analysis set out in those Annexes, we are of the view that our conclusions in part IV.3 of this memorandum relating to the English Transfer Annex apply equally to an English Insurance Company.

ANNEX 11

STANDARD CHARTERED BANK

In this Annex 11, we set out our views regarding the enforceability of the Credit Support Documents in the event that resolution action or insolvency proceedings are commenced in England in respect of Standard Chartered Bank.

1. Legal form and regulatory status of Standard Chartered Bank

Standard Chartered Bank was incorporated in England with limited liability by royal charter in 1853 as The Chartered Bank of India, Australia and China, changing its name to The Chartered Bank in 1956 and to Standard Chartered Bank in 1985.

Standard Chartered Bank is currently governed by a royal charter, bye-laws and rules dated 1 January 1985. The Royal Charter was most recently amended on 22 March 2005 (the **Charter**).

Standard Chartered Bank is therefore a Chartered Corporation. Standard Chartered Bank is therefore not an English Bank as defined in this memorandum. It is, however, a Bank/Credit Institution as defined in Appendix B.

Although Standard Chartered Bank is not registered under the Companies Act 2006, a number of provisions of the Companies Act 2006 apply to it as an "unregistered company" pursuant to section 1043 of the Companies Act 2006 and the Unregistered Companies Regulations 2009, which are made under that section.[343]

Standard Chartered Bank appears in the records of the registrar of companies as a chartered corporation under reference number ZC000018 with its principal office at 1 Basinghall Avenue, London, EC2V 5DD.

According to the register of persons authorised to conduct regulated activities maintained by the FCA and the PRA,[344] Standard Chartered Bank is an authorised person under the Financial Services and Markets Act 2000 with permission under part 4A of the Financial Services and Markets Act 2000 to engage in the regulated activity of accepting deposits (Financial Services Register number 114276).

2. Conclusions

2.1 On the basis of the assumptions and subject to the qualifications in this memorandum as modified and supplemented by Annex 1, Annex 9 and this Annex 11, we are of the view that our conclusions in part III and part IV of this memorandum would also apply to Standard Chartered Bank, in the event that insolvency proceedings are commenced in England in respect of Standard Chartered Bank.

2.2 On the basis of the assumptions and subject to the qualifications in this memorandum as modified and supplemented by Annex 1, Annex 9 and this Annex 11, we are of the view that our conclusions in paragraphs 2.2 (Part VII of the Financial Services and Markets Act 2000) and 2.3 (Banking Act) of Annex 1 to would also apply to Standard Chartered Bank.

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343 SI 2009/2436.

344 The Financial Services Register may be consulted at https://register.fca.org.uk. The information in the text was confirmed by reference to the Financial Services Register on that website on 30 December 2015.

3. Analysis

3.1 *Insolvency Proceedings in respect of Standard Chartered Bank*

Standard Chartered Bank is a Chartered Corporation and therefore, except as otherwise stated below, the insolvency proceedings set out in respect of a Chartered Corporation at Annex 9 will apply to Standard Chartered Bank. As Standard Chartered Bank is an English Bank, paragraph 2.1 of Annex 1 would also apply relating to the powers of the FCA and the PRA on an insolvency.

However, as Standard Chartered Bank is a bank it is not subject to the EC Insolvency Regulation and therefore it would only be wound up on a compulsory basis under section 221 of the Insolvency Act (and not on a voluntary basis).

3.2 *Winding up by revocation of Charter*

As noted in Annex 9, in addition to statutory insolvency proceedings, Standard Chartered Bank could be wound up under the Charter[345] in the following circumstances:

(a) as a result of the revocation of the Charter under Provision 17 thereof, by the Crown:

(i) on any suspension of payments by Standard Chartered Bank for any continuous period of sixty days or any number of days at intervals that amount altogether to sixty days within one year;

(ii) if the Commissioners of Her Majesty's Treasury report to the Crown that Standard Chartered Bank has not complied with the Charter; or

(iii) if it appears to the Crown that there is any other good and sufficient reason; or

(b) under Bye-Law 140 of the Charter, by Special Resolution of the members (shareholders) of Standard Chartered Bank on the recommendation of its Court of directors (in effect, its board of directors).

Under the Charter, the Court of directors of Standard Chartered Bank has the full power to carry out the winding up of the affairs of Standard Chartered Bank "by all necessary ways and means", and all powers conferred by the Charter on Standard Chartered Bank as a body corporate remain exercisable by the Court of directors. Under Provision 20 of the Charter, if the Charter is revoked, the following will occur:

(x) the property of Standard Chartered Bank will be converted into money, the debts due to Standard Chartered Bank will be collected and unpaid calls on shares will be collected;

(y) the monies collected as described in (x) will be applied in paying the debts and liabilities of Standard Chartered Bank "in due course of Law" (which we interpret to refer to all applicable English law, including English insolvency law, and any applicable foreign law, including foreign insolvency law to the extent it applies to a

345 See Provision 20 of the Charter and Bye-Law 141

branch of Standard Chartered Bank that is subject to winding up under that foreign insolvency law);[346] and

(z) any surplus monies after payment of the debts and liabilities of Standard Chartered Bank would be divided among the members of Standard Chartered Bank in accordance with their rights and priorities.

Provision 20 broadly reflects the functions of a liquidator in a winding up of an English Company, as set out in section 143 of the Insolvency Act 1986. However, the grounds for winding up Standard Chartered Bank under Provision 17 and Bye-Law 140 of the Charter are not consistent with the normal grounds for winding up under the Insolvency Act 1986, and there is no clear authority on how this inconsistency would be resolved.

We believe that it is highly unlikely that Standard Chartered Bank would be wound up under these provisions of the Charter, given that a bank of the size of Standard Chartered Bank would almost certainly enter the special resolution regime under the Banking Act if it were to fail. If that did not occur for any reason, the next most likely outcome would be that it to be wound up under section 221 of the Insolvency Act 1986 as an unregistered company. Rather than exercise its rights under the Charter, the Crown would almost certainly defer to the PRA or its successor as the principal regulator of Standard Chartered Bank for such purposes, and the regulator would almost certainly insist that the winding up of Standard Chartered Bank be carried out in accordance with the provisions of the Banking Act or the Insolvency Act 1986 referred to above.

Finally, even in the unlikely event that Standard Chartered Bank were wound up under the Charter as described in this paragraph 3.2 of this Annex 11, we do not believe that there is anything in the Charter or in applicable law that would permit the Court of directors of Standard Chartered Bank to take any action that would have a material adverse effect on the operation of the Credit Support Documents.

3.3 *Scheme of arrangement*

As set out in Annex 9 it is possible that a Chartered Corporation, such as Standard Chartered Bank, could be made subject to a scheme of arrangement under Part 26 of the Companies Act 2006.

Standard Chartered Bank is incorporated by royal charter, has its principal office in England and has its principal or home regulators in England, namely, the FCA and the PRA. Given those circumstances, it seems sufficiently clear to us that Standard Chartered Bank would fall within clause (b) of the definition of "company" set out at Annex 9.

3.4 *Part VII of the Financial Services and Markets Act 2000*

The provisions of Part VII of the Financial Services and Markets Act 2000, which are described in part 2.2 of Annex 1 in relation to an English Bank, would also apply to Standard Chartered Bank. Our analysis of the effect of Part VII of the Financial Services and Markets Act 2000 on the Credit Support Documents in relation to an English Bank would apply equally in relation to Standard Chartered Bank, without additional qualification.

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346 Of course the Winding Up Directive would prevent there being any such proceedings in relation to a branch of Standard Chartered Bank in any other EEA member state. But such proceedings could be opened in relation to a branch in a jurisdiction outside the EEA, if local law in the branch jurisdiction would permit or require this.

3.5 *Banking Act*

Standard Chartered Bank falls within the definition of "bank" in section 2 of the Banking Act. Therefore each of the following parts of the Banking Act apply to Standard Chartered Bank to the same extent as to an English Bank, as described in paragraph 2.3 of Annex 1 to this memorandum, namely, Part 1 (special resolution regime), Part 2 (bank insolvency) and Part 3 (bank administration).

We assume that Standard Chartered Bank holds client assets. Given its permissions and the fact it is incorporated in England, Standard Chartered Bank would therefore be an "investment bank" and is also subject to Special Administration (Bank Insolvency) and Special Administration (Bank Administration) assuming that it does have eligible depositors. However, if Standard Chartered Bank has no depositors that are eligible for compensation under the FSCS, Special Administration (Bank Insolvency) will not apply and Investment Bank Special Administration may apply instead.

Therefore our analysis in paragraph 2.3 of Annex 1 to this memorandum in respect of an English Bank in the event of its becoming subject to the SRR in Part 1 of the Banking Act or being made subject to the Bank Insolvency Procedure, the Bank Administration Procedure, Special Administration (Bank Insolvency), Special Administration (Bank Administration) or Investment Bank Special Administration applies equally to Standard Chartered Bank, without additional qualification.

3.6 *Standard Chartered Bank and the Winding Up Regulations*

Standard Chartered Bank falls within the definition of "UK credit institution" in the Winding Up Regulations and is subject to the Winding Up Regulations on the same basis as an English Bank. See paragraph 2.1 of Annex 1 and Appendix D of the ISDA Netting Opinion in respect of the treatment of New York law governed ISDA Master Agreements. See also paragraph 2.4 of Part 1 of Annex 1 hereto for additional discussion of the application of the various derogations in the Winding Up Regulations to the Credit Support Documents.

3.7 *Standard Chartered Bank and the FCA Regulations*

See paragraph 2.5 of Part 1 of Annex 1 hereto in relation to the application of the FCA Regulations to the additional insolvency proceedings discussed at paragraph 3.5 above and the interaction between the SRR and the FCA Regulations.

4. SECURITY DOCUMENTS

On the basis of the assumptions and subject to the qualifications in this memorandum as modified and supplemented by Annex 1, Annex 9 and this Annex 11 as applicable and subject to the analysis set out in those Annexes, we are of the view that the analysis in part III.3 of this memorandum of issues relating to the enforceability of Security Documents against a Security Collateral Provider would apply in circumstances where the Security Collateral Provider is Standard Chartered Bank.

5. ENGLISH TRANSFER ANNEX

On the basis of the assumptions and subject to the qualifications in this memorandum as modified and supplemented by Annex 1, Annex 9 and this Annex 11 as applicable and subject to the analysis set out in those Annexes, we are of the view that the analysis in part IV.3 of this memorandum would apply in the event that insolvency proceedings are commenced in England in respect of Standard Chartered Bank.

ANNEX 12

ENGLISH CHARITY – TRUSTEE OF AN ENGLISH CHARITABLE TRUST

In this Annex 12, we set out our views on the enforceability of the Credit Support Documents against the Trustee of an English Charitable Trust in the event that insolvency proceedings are commenced in England in respect of the Trustee or a Trust Insolvency occurs in relation to the English Charitable Trust.

Application of general trust law to English Charitable Trusts

This Annex 12 should be read together with the analysis of Trustees and English Trusts elsewhere in this memorandum, in particular in part I.2, Appendix D and Annex 5. That analysis applies to the Trustee of an English Charitable Trust, as supplemented by this Annex 12.

Investment manager for the Trustee of an English Charitable Trust

It is common for the Trustee of an English Charitable Trust to appoint an investment manager to act as agent for the Trustee for certain purposes. In such a case, a party would enter into an ISDA Master Agreement, a Credit Support Document and each Transaction under that ISDA Master Agreement, with an investment manager acting as agent for the Trustee of the English Charitable Trust rather than directly with the Trustee. The investment manager will have been appointed by the Trustee pursuant to a power to do so in the trust deed for the English Charitable Trust, and subject to any applicable requirements of the trust deed. The terms of the investment manager's appointment and the scope of its authority as agent will be determined by an investment management agreement between the investment manager and the Trustee.

Provided that the investment manager has been validly appointed and is acting within the scope of its authority in entering into an ISDA Master Agreement, a Credit Support Document and each Transaction with a party, and in performing any obligations of the Trustee on behalf of the English Charitable Trust, then the Credit Support Document will form part of a contractual relationship between the party and the Trustee directly. A failure by the investment manager to perform an obligation of the Trustee under a Credit Support Document will constitute a failure to perform by the Trustee in just the same manner as if the Trustee had been dealing directly with the party.

The commencement of insolvency proceedings in relation to the investment manager will normally effect a revocation of its authority to act as agent of the Trustee or to continue to perform the obligations of the Trustee after the effective date of such revocation, but will not otherwise affect the enforceability of a Credit Support Document against the Trustee.

Our analysis of the enforceability of the Credit Support Documents against the Trustee of an English Charitable Trust is not affected by whether the Trustee has entered into the relevant Credit Support Document directly with the other party or through an investment manager acting as agent. Therefore we do not need to give further consideration to the role of the investment manager in this Annex 12.

SECURITY DOCUMENTS AND ENGLISH TRANSFER ANNEX

Although the charitable sector is heavily regulated, the insolvency proceedings applicable to an English Charity are determined by its legal form. In contrast to the insurance sector, there are no special insolvency rules that apply to an English Charity under charities law or that modify the rules that would otherwise apply to the English Charity.

Therefore the special regulatory regime that applies to an English Charitable Trust under the Charities Act 2011 has no material effect on the analysis or conclusions in Annex 5 in the event that insolvency proceedings are commenced in England in respect of the Trustee or a Trust Insolvency occurs in respect of the English Charitable Trust.

ANNEX 13

ENGLISH CHARITY – OTHER FORMS OF ENGLISH CHARITY

In this Annex 13, we set out our views on the enforceability of the Credit Support Documents against an English Charity other than a Trustee of an English Charitable Trust in the event that insolvency proceedings are commenced in England in respect of the English Charity.

Application of Insolvency Law to Charities

The types of insolvency proceeding that may be commenced in England in respect of an English Charity are, in respect of an English Charity established as:

(a) an English Company, set out in part III.1(4) of the ISDA Netting Opinion;

(b) a Friendly Society, set out in Annex 6;

(c) a C/CB Society, set out in Annex 7;[347]

(d) a Statutory Corporation, set out in Annex 8; and

(e) a Chartered Corporation, set out in Annex 9.

Although the charitable sector is heavily regulated, the insolvency proceedings applicable to an English Charity are determined by its legal form. In contrast to the insurance sector, there are no special insolvency rules that apply to an English Charity under charities law or that modify the rules that would otherwise apply to the English Charity.

Investment manager for the English Charity

It is common for an English Charity to appoint an investment manager to act as agent for the English Charity for certain purposes. In such a case, a party would enter into an ISDA Master Agreement, a Credit Support Document and each Transaction under that ISDA Master Agreement with an investment manager acting as agent for the English Charity rather than directly with the English Charity. The terms of the investment manager's appointment and the scope of its authority as agent will be determined by an investment management agreement between the investment manager and the English Charity.

Provided that the investment manager has been validly appointed and is acting within the scope of its authority in entering into an ISDA Master Agreement, the Credit Support Document and each Transaction under that ISDA Master Agreement with a party, and in performing any obligations of the English Charity, then the Credit Support Document will form part of a contractual relationship between the party and the English Charity directly. A failure by the investment manager to perform an obligation of the English Charity under a Credit Support Document will constitute a failure to perform by the English Charity in just the same manner as if the English Charity had been dealing directly with the party.

The commencement of insolvency proceedings in relation to the investment manager will normally effect a revocation of its authority to act as agent of the English Charity or to continue to perform the

347 See note 12 in respect of English Charities established in the form of a C/CB.

obligations of the English Charity after the effective date of such revocation, but will not otherwise affect the enforceability of the Credit Support Document against the English Charity.

Our analysis of the enforceability of the Credit Support Documents against an English Charity is not affected by whether the English Charity has entered into the Credit Support Document directly with the other party or through an investment manager acting as agent. Therefore we do not need to give further consideration to the role of the investment manager in this Annex 13.

1. SECURITY DOCUMENTS

Conclusion

On the basis of the assumptions and subject to the qualifications in this memorandum as modified and supplemented by this Annex 13 and, where applicable, each of Annexes 6, 7, 8 and 9 and subject to the analysis set out in those Annexes, we are of the view that the analysis in part III.3 of this memorandum of issues relating to the enforceability of the Security Documents against a Security Collateral Provider would apply in circumstances where the Security Collateral Provider is an English Charity.

2. ENGLISH TRANSFER ANNEX

Conclusion

On the basis of the assumptions and subject to the qualifications in this memorandum as modified and supplemented by this Annex 13 and, where applicable, each of Annexes 6, 7, 8 and 9 and subject to the analysis set out in those Annexes, we are of the view that the analysis in part IV.3 of this memorandum would apply in circumstances where insolvency proceedings are commenced in England in respect of an English Charity.

ENGLISH INVESTMENT FUND – OPEN-ENDED INVESTMENT COMPANY

In this Annex 14, we set out our views on the enforceability of the Credit Support Documents against an Open-Ended Investment Company in the event that insolvency proceedings are commenced in England in respect of the Open-Ended Investment Company.

Subject to the more detailed discussion below, the types of insolvency proceeding that may be commenced in England in respect of an Open-Ended Investment Company are a voluntary or compulsory winding under the Insolvency Act 1986 and a scheme of arrangement under Part 26 of the Companies Act 2006.[348] As noted in our answer to question 20 in part III, the EC Insolvency Regulation does not apply to collective investment schemes.

UCITS authorised schemes, non UCITS retail schemes and qualified investor schemes

An Open-Ended Investment Company is a collective investment scheme for purposes of Part XVII (sections 235 – 284) of the Financial Services and Markets Act 2000. Under section 262 of the Act, the Treasury was given the power to make the OEIC Regulations. Under regulation 6 of the OEIC Regulations, the Financial Conduct Authority has authority to make rules for Open-Ended Investment Companies. This power has been exercised and the relevant rules can be found in the Collective Investment Schemes Sourcebook (**COLL**). The rules in COLL distinguish between various categories of collective investment scheme. An Open-Ended Investment Company might, therefore, be a UCITS authorised scheme (that is, subject to rules consistent with the UCITS Directive[349]), a non UCITS retail scheme or a non retail scheme (otherwise known as a "qualified investor scheme").

Our conclusions below are not affected by whether the Open-Ended Investment Company is a UCITS authorised scheme, non-UCITS retail scheme or a non-retail scheme (qualified investor scheme).

Authorised corporate director or investment manager for the Open-Ended Investment Company

Regulation 15 of the OEIC Regulations provides, among other things, that an Open-Ended Investment Company must have at least one director and, if it has a single director, the single director must be a body corporate which is an authorised person with permission under Part 4A of the Financial Services and Markets Act 2000 to carry on the regulated activity of managing a UCITS or, as the case may be, managing an Alternative Investment Fund. This director is known as the authorised corporate director (**ACD**) of the Open-Ended Investment Company. Under COLL a Open-Ended Investment Company is expected to have at all times an appropriately qualified ACD, even if it has more than one director.[350]

In practice, a party may enter into an ISDA Master Agreement, a Credit Support Document and each Transaction under that ISDA Master Agreement, with the ACD acting as agent for the Open-Ended Investment Company or with an investment manager appointed by the ACD acting as agent for the Open-Ended Investment Company.

In relation to dealing with the ACD, the same considerations apply as when dealing with the director, officer or other representative of any company, namely, whether the director, officer or other

348 Regulation 21 and COLL 7 provide for an alternative winding up procedure but this is only available to solvent Open-Ended Investment Companies (see COLL 7.3.4(R)(3)).

349 Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS).

350 COLL 6.5.3.

representative has the appropriate authority to act on behalf of the company when entering into an agreement such as the Credit Support Documents. As discussed in part 1.3 of this memorandum, we have assumed, among other things, that the persons entering into the Credit Support Documents on behalf of each party have the necessary authority. When a party enters into an ISDA Master Agreement, a Credit Support Document and each Transaction under the ISDA Master Agreement with the duly authorised ACD acting on behalf of an Open-Ended Investment Company, then the party is in a direct contractual relationship with the Open-Ended Investment Company.

In relation to dealing with an investment manager, the investment manager will have been appointed by the ACD. The terms of the investment manager's appointment and the scope of its authority as agent will be determined by an investment management agreement with the investment manager.

Provided that the investment manager has been validly appointed and is acting within the scope of its authority in entering into an ISDA Master Agreement, a Credit Support Document and each Transaction with a party, and in performing any obligations of the Open-Ended Investment Company, then the Credit Support Document will form part of a contractual relationship between the party and the Open-Ended Investment Company directly.

A failure by the ACD or investment manager to perform an obligation of the Open-Ended Investment Company under the the Credit Support Document will constitute a failure to perform by the Open-Ended Investment Company in just the same manner as if the Open-Ended Investment Company had been dealing directly with the party.

The commencement of insolvency proceedings in relation to the ACD or investment manager will normally effect a revocation of its authority to act as agent of the Open-Ended Investment Company or to continue to perform the obligations of the Open-Ended Investment Company after the effective date of such revocation, but will not otherwise affect the enforceability of the Credit Support Documents against the Open-Ended Investment Company.

Our analysis of the enforceability of the close out netting provisions of the Credit Support Documents against an Open-Ended Investment Company is not affected by whether the Open-Ended Investment Company has entered into the Credit Support Documents directly with the other party or through an investment manager acting as agent. Therefore we do not need to give further consideration to the role of the investment manager in this Annex 14.

Insolvency proceedings in respect of an Open-Ended Investment Company (other than an Umbrella Company)

Regulation 31 of the OEIC Regulations provides that an Open-Ended Investment Company may be wound up as an unregistered company under Part V of the Insolvency Act 1986, subject to certain modifications that are not relevant to the issues we are considering in this Annex 14. Whether the winding up of an Open-Ended Investment Company is conducted on a voluntary or compulsory basis, the provisions of the Insolvency Rules 1986 relevant to a winding up will apply to the winding up of the Open-Ended Investment Company, including the insolvency set off provision in Rule 4.90.

An Open-Ended Investment Company may not be made subject to a CVA or to administration proceedings under the Insolvency Act 1986. Each of these regimes is limited to English Companies and certain foreign companies.[351]

351 In relation to company voluntary arrangements, see the definition of "company" in section 1(4) of the Insolvency Act 1986, and in relation to administration proceedings, see the definition of "company" in paragraph 111(1A) of Schedule B1 to the Insolvency Act 1986.

Regulation 70 and Schedule 6 of the OEIC Regulations provide that an Open-Ended Investment Company can be subject to a scheme of arrangement under Part 26 of the Companies Act 2006, subject to the amendments made to Part 26 by the OEIC Regulations and the provisions of COLL 7.6.[352]

Open-Ended Investment Companies that are Umbrella Companies

Open-Ended Investment Companies are commonly structured such that investors invest in separate funds. In the past this was achieved via the contractual segregation of the assets and liabilities of the separate funds.

The Open-Ended Investment Companies (Amendment) Regulations 2011 (the **2011 Regulations**) amended the OEIC Regulations and COLL was also amended to establish a protected cell regime under English law (the **PCC Regime**). Under the PCC Regime, an Open-Ended Investment Company that is an umbrella company (as defined in the OEIC Regulations) (an **Umbrella OEIC**) is made up of sub-funds (as defined in the OEIC Regulations).

The assets of a sub-fund belong exclusively to the relevant sub-fund and may not be used to discharge the liabilities of or claims against the Umbrella OEIC or any other sub-fund. Similarly any liability incurred on behalf of or attributable to any sub-fund of an Umbrella OEIC may only be discharged from the assets of the relevant sub-fund. The sub-funds do not have legal personality separate from the Umbrella OEIC but the property of the sub-fund is subject to orders of the court as it would have been had the sub-fund been a separate legal person and may exercise the same rights of set-off in respect of a sub-fund that apply in respect of companies.[353] The exception to the general rule is assets that are received or liabilities that are incurred by the Umbrella OEIC on behalf of its sub-funds in order to enable the operation of those sub-funds and which are not attributable to any particular sub-fund may be allocated between the sub-funds in a manner which the umbrella company considers is fair to shareholders.

The 2011 Regulations provided a transitional compliance period and all Open-Ended Investment Companies using contractual sub-fund structures were obliged to amend their instruments of incorporation to comply with the PCC Regime within the compliance period. The compliance period has now expired. In light of the expiry of the compliance period, we do not consider the position with respect to Umbrella OEICs that have not amended their instruments of incorporation to comply with the PCC Regime.

As discussed above, in respect of Umbrella OEICs, a limitation of the liabilities of a sub-fund is effected by operation of law[354]. Furthermore, any provision of an agreement, contract or otherwise entered into by an Umbrella OEIC which is inconsistent with the principle of limited recourse is void as a matter of law[355]. Therefore, any provision of an ISDA Master Agreement or Credit Support Document that provides that the liabilities of one sub-fund of an Umbrella OEIC may be satisfied from the assets of another sub-fund of the same Umbrella OEIC will be inconsistent with the PCC Regime, and thus void.

Umbrella OEICs have not been permitted to enter into any agreement or contract which is inconsistent with the principle of limited recourse since 21 December 2011.

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352 We have not considered any other form of scheme that may be applicable to an Open-Ended Investment Company such as a merger by scheme of arrangement under the Undertakings for Collective Investment in Transferable Securities Regulations 2011.

353 Regulation 11A(5) and (6) of the OEIC Regulations.

354 Regulation 3 of the 2011 Regulations creating *inter alia* a Regulation 11A in the OEIC Regulations.

355 Regulation 11A (3) of the OEIC Regulations.

Umbrella OEICs – Insolvency Proceedings

For the reasons given above, each sub-fund of an Umbrella OEIC may be wound up separately under the insolvency procedure for Open-Ended Investment Companies as set out above subject to certain modifications that are not relevant to the issues we are considering in this Annex 14 and the above conclusions in respect of an Open-Ended Investment Company therefore apply in respect of the winding up of an individual sub-fund.

The provisions of the OEIC Regulations addressing schemes of arrangement under Part 26 were not amended when the PCC Regime was introduced and the relevant provisions simply refer to an Open-Ended Investment Company. An Umbrella OEIC is a form of Open-Ended Investment Company and therefore could be subject to a scheme of arrangement under Part 26 of the Companies Act 2006.

Whilst not strictly necessary because the sub-fund does not have its own legal personality, parties contracting with an Umbrella OEIC may wish to clarify that Bankruptcy under Section 5 of the ISDA Master Agreement would still be triggered if the events occurred only in respect of the relevant sub-fund and not the Umbrella OEIC as a whole.

1. SECURITY DOCUMENTS[356]

On the basis of the assumptions and subject to the qualifications in this memorandum as modified and supplemented by this Annex 14 and subject to the analysis set out in this Annex, we are of the view that the analysis in part III.3 of this memorandum of issues relating to the enforceability of the Security Documents against a Security Collateral Provider would apply in circumstances where the Security Collateral Provider is an Open-Ended Investment Company, subject to the following:

(a) the Registration Provisions will not apply because an Open-Ended Investment Company is not an English Company;

(b) on the basis that the administration provisions in Part II of the Insolvency Act 1986 are not applicable to an Open-Ended Investment Company, our answers to the questions in part III.3 of this memorandum which relate to administration should be disregarded. The same is true of CVAs (and so, for example, our explanation in the body of this memorandum of the "eligible company" moratorium under the Insolvency Act 2000 is not relevant to an Open-Ended Investment Company);

(c) in respect of an Umbrella OEIC subject to the requirements that (i) a separate ISDA Master Agreement and Credit Support Document be entered into in respect of each sub-fund which in each case clearly identifies the relevant sub-fund; and (ii) each Transaction with the Umbrella OEIC is allocated to the ISDA Master Agreement that has been entered into in respect of the relevant sub-fund.

2. ENGLISH TRANSFER ANNEX

2.1 Conclusion

On the basis of the assumptions and subject to the qualifications in this memorandum as modified and supplemented by this Annex 14 and subject to the analysis set out in this Annex

[356] Note that COLL 5.5.7(3) provides that none of the scheme property can be mortgaged. However, COLL 5.5.7(4) includes a carve out for lending, depositing, pledging or charging scheme property for margin requirements.

14, we are of the view that our conclusions in part IV.3 of this memorandum would apply to an Open-Ended Investment Company in the event that insolvency proceedings are commenced in England in respect of the Open-Ended Investment Company.

2.2 Analysis

In respect of an Umbrella OEIC, the following analysis is subject to the requirements that (i) a separate ISDA Master Agreement and English Transfer Annex be entered into in respect of each sub-fund which in each case clearly identifies the relevant sub-fund and (ii) each Transaction with the Umbrella OEIC is allocated to the ISDA Master Agreement that has been entered into in respect of the relevant sub-fund.

Subject to the above, if an Open-Ended Investment Company or a sub-fund thereof were wound up as an "unregistered company" under section 221 of the Insolvency Act 1986, then, in our view, the close-out netting provisions of the ISDA Master Agreement would be enforceable against that Open-Ended Investment Company or sub-fund for the reasons we give in part III.3(3)(a) of the ISDA Netting Opinion in relation to an English Company on the basis that the close-out netting provisions of the ISDA Master Agreement do not involve contractual set-off (other than to the limited extent that it includes Unpaid Amounts owed by either party that became payable prior to the operation of Section 6(c)(ii) of the ISDA Master Agreement, as discussed in the ISDA Netting Opinion) but simply represent an accounting of rights and liabilities under a single agreement following the designation or deemed occurrence of an Early Termination Date (sometimes referred to as the "flawed asset" approach to close-out netting).

If, however, the court were to construe the close-out netting provisions of the ISDA Master Agreement as operating by way of contractual set-off rather than pursuant to the single agreement (or "flawed asset") approach described above, we also consider that the close-out netting provisions of the ISDA Master Agreement would be enforceable against the Open-Ended Investment Company or sub-fund thereof for the reasons set out in part III.3(3)(a) of the ISDA Netting Opinion in relation to an English Company.

In addition to the arguments above, if the English Transfer Annex forms part of a financial collateral arrangement under the FCA Regulations as discussed in part II above, regulation 12 provides that a close-out netting provision shall, subject to paragraph (2), take effect in accordance with its terms notwithstanding that the collateral-provider or collateral-taker under the arrangement is subject to winding-up proceedings or reorganisation measures.

If an Open-Ended Investment Company or a sub-fund thereof were to enter into a scheme of arrangement under Part 26 of the Companies Act 2006, the close-out netting provisions of the ISDA Master Agreement would be enforceable against the Open-Ended Investment Company on the same basis as the close-out netting provisions would be enforceable against an English Company, as set out in part III.3(3)(d) of the ISDA Netting Opinion.

Since the English Transfer Annex relies for its effectiveness on the inclusion of the Credit Support Balance within the scope of the close-out netting provisions in Section 6(e) of the ISDA Master Agreement, we are of the view that an English court would find the title transfer collateral arrangement effected by the English Transfer Annex is enforceable against an Open-Ended Investment Company in the event of its winding up in England.

ANNEX 15

ENGLISH INVESTMENT FUND – TRUSTEE OF AN AUTHORISED UNIT TRUST

In this Annex 15, we set out our views on the enforceability of the Credit Support Documents against the Trustee of an Authorised Unit Trust[357] in the event that insolvency proceedings are commenced in England in respect of the Trustee or a Trust Insolvency occurs in respect of the Authorised Unit Trust.

Application of general trust law to Authorised Unit Trusts

This Annex 15 should be read together with the analysis of Trustees and English Trusts elsewhere in this memorandum, in particular in part I.2, Appendix D and Annex 5. That analysis applies to the Trustee of an Authorised Unit Trust, as supplemented by this Annex 15.

UCITS authorised schemes, non UCITS retail schemes and qualified investor schemes

An Authorised Unit Trust is a collective investment scheme for purposes of Part XVII (sections 235 – 284) of the Financial Services and Markets Act 2000. Under section 247 of the Act, the Financial Conduct Authority has authority to make rules for Authorised Unit Trusts. This power has been exercised and the relevant rules can be found in the Collective Investment Schemes Sourcebook (**COLL**). The rules in COLL distinguish between various categories of collective investment scheme. An Authorised Unit Trust might, therefore, be a UCITS authorised scheme (that is, subject to rules consistent with the UCITS Directive[358]), a non UCITS retail scheme or a non retail scheme (otherwise known as a "qualified investor scheme").

Our conclusions regarding the enforceability of the Credit Support Documents against a Trustee of an Authorised Unit are not affected by whether the Authorised Unit Trust is a UCITS authorised scheme, non UCITS retail scheme or a non retail scheme (qualified investor scheme).

Investment manager for the Trustee of an Authorised Unit Trust

In practice, it is likely that a party will enter into an ISDA Master Agreement, a Credit Support Document and each Transaction under that ISDA Master Agreement, with an investment manager acting as agent for the Trustee of an Authorised Unit Trust rather than directly with the Trustee. The investment manager will have been appointed by the Trustee pursuant to a power to do so in the trust deed for the Authorised Unit Trust, and subject to any applicable requirements of the trust deed. The terms of the investment manager's appointment and the scope of its authority as agent will be determined by an investment management agreement between the investment manager and the Trustee.

Provided that the investment manager has been validly appointed and is acting within the scope of its authority in entering into an ISDA Master Agreement, a Credit Support Document and each Transaction with a party, and in performing any obligations of the Trustee on behalf of the Authorised Unit Trust, then the Credit Support Document will form part of a contractual relationship between the party and the Trustee directly. A failure by the investment manager to perform an obligation of the Trustee under the Credit Support Document will constitute a failure to perform by the Trustee in just the same manner as if the Trustee had been dealing directly with the party.

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357 By unit trust scheme we mean a single trust created in favour of a single defined pool of beneficiaries rather than a scheme that is an umbrella (as such term is used in the Collective Investment Schemes sourcebook forming part of the FCA Handbook).

358 Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS).

The commencement of insolvency proceedings in relation to the investment manager will normally effect a revocation of its authority to act as agent of the Trustee or to continue to perform the obligations of the Trustee after the effective date of such revocation, but will not otherwise affect the enforceability of the Credit Support Documents against the Trustee.

Our analysis of the enforceability of the Credit Support Documents against the Trustee of an Authorised Unit Trust is not affected by whether the Trustee has entered into the Credit Support Documents directly with the other party or through an investment manager acting as agent. Therefore we do not need to give further consideration to the role of the investment manager in this Annex 15.

SECURITY DOCUMENTS[359] AND ENGLISH TRANSFER ANNEX

Although Authorised Unit Trusts are heavily regulated, the insolvency proceedings in respect of the Trustee of the Authorised Unit Trust or the occurrence of a Trust insolvency are determined by the characteristics of the Authorised Unit Trust's legal form (i.e. its status as an English law Trust) (although as noted in our answer to question 20 in part III, the EC Insolvency Regulation does not apply to collective investment schemes).

Therefore the special regulatory regime that applies to an Authorised Unit Trust under the Financial Services and Markets Act 2000 has no material effect on the analysis or conclusions in Annex 5.[360]

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359 See note 356 above in respect of the restrictions in COLL 5.5.7.

360 As set out in Annex 5, the insolvency proceedings that may be commenced in respect of the Trustee are the same as those that would apply in respect of an English Company. In respect of schemes of arrangement, we have not considered any other form of scheme that may be applicable to an Authorised Unit Trust such as a merger by scheme of arrangement under the Undertakings for Collective Investment in Transferable Securities Regulations 2011. COLL 7.4 (Winding up an AUT and terminating a sub-fund of an AUT) in our view addresses the solvent winding up of an AUT rather than an insolvent winding up and is therefore also not addressed in this opinion.

ANNEX 16

BANK OF ENGLAND

In this Annex 16, we set out our views on the enforceability of the Credit Support Documents against the Bank of England.

The Bank of England is a Chartered Corporation, having been established by a royal charter granted on 27 July 1694. The charter was supplemented by the Bank of England Act 1694 and has subsequently been amended and updated. The Bank of England acts as the Central Bank of the United Kingdom and therefore was established for and continues to serve a unique and important public purpose.

Although a Chartered Corporation would normally be liable to be wound up as an unregistered company under Part V of the Insolvency Act 1986, there is good authority for the view that a statutory corporation established under a public general Act of Parliament is not liable to be wound up as an unregistered company under the Insolvency Act 1986.[361] We believe that this authority would be followed in relation to the Bank of England notwithstanding its status as a Chartered Corporation rather than a statutory corporation established under a public general Act of Parliament.

Accordingly, the conclusions and analysis at III(3) and IV(3) of this memorandum as modified by Annex 9 will apply except that the discussion relating to the analysis of insolvency law will not be relevant. If we are wrong and an English court would wind up the Bank of England as an unregistered company, then the conclusions and analysis at III(3) and IV(3) of this memorandum as modified by Annex 9 in respect of Chartered Corporations other than the Bank of England will apply.

The Bank of England is a separate legal person from the Crown and therefore does not share in the sovereign immunity of the Crown (although it does have an immunity from damages when acting in its capacity as a monetary authority under section 244 of the Banking Act).

Although not strictly speaking a legal issue, given the Bank of England's unique nature as the Central Bank of the United Kingdom, it is fair to point out that there is potentially a degree of political risk in dealing with the Bank of England that may be considered, relatively speaking, higher than in dealing with a private sector English Bank. Broadly the considerations that would be relevant are those discussed in Annex 17 in relation to the United Kingdom acting through Her Majesty's Treasury.

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361 See note 7 and 307

ANNEX 17

THE UNITED KINGDOM ACTING THROUGH HER MAJESTY'S TREASURY

In this Annex 17, we set out our views on the enforceability of the English Transfer Annex against the United Kingdom (the **Crown**) acting through Her Majesty's Treasury.

Under section 5 of and Schedule 1 to the Interpretation Act 1978, "[t]he Treasury" means the Commissioners of Her Majesty's Treasury. The Treasury is a department of the government of the United Kingdom without separate legal personality. As such, an English Transfer Annex entered into between a Counterparty and the Treasury constitutes an agreement between the Counterparty and the Crown.

As far as English law is concerned, there is no insolvency regime for the Crown or for the Treasury as a department of the Crown. In other words, it is not possible to institute formal insolvency proceedings against the Crown or against the Treasury in any English court. We are not aware of any jurisdiction that would apply its domestic insolvency regime to its own sovereign or would purport to apply it to a foreign sovereign, but even if there were such a jurisdiction, an English court would not recognise the effect of any foreign insolvency proceedings purportedly instituted against the Crown or the Treasury.

Accordingly, in respect of the English Transfer Annex, the analysis at part IV of this memorandum will apply except that given the nature of the fact pattern that we have been asked to analyse in this Annex, the discussion relating to (i) the Collateral Directive and the FCA Regulations in Part II and Part IV of this memorandum; and (ii) the analysis of insolvency law will not be relevant.

Without prejudice to the foregoing, an ISDA member contemplating entering into an ISDA Master Agreement and an English Transfer Annex with the Crown acting through the Treasury may wish to bear the following additional points in mind:

1. Sovereign immunity

In relation to a Sovereign, the question naturally arises as to whether the Sovereign enjoys immunity from jurisdiction or immunity from execution. The considerations below apply to actions against the Crown in an English court.[362]

(a) Immunity from jurisdiction

In the United Kingdom, the principle that civil proceedings may be instituted against the Crown was established by the Crown Proceedings Act 1947, and any such proceedings are largely governed by that Act and by Part 66 of the Civil Procedure Rules 1998.

Prior to the Crown Proceedings Act 1947 coming into force, the Crown was recognised as being liable for a debt or for a breach of contract, but claims could only be enforced by a petition of right which needed the consent of the Crown. Section 1 of the Act abolished this requirement. In other words, the normal rules governing contractual liability apply to the Crown, conferring jurisdiction on the English courts in relation to civil proceedings against the Crown. These rules will therefore apply to an ISDA Master Agreement and English Transfer Annex between a party and the Crown acting through the Treasury.

362 The position in relation to a foreign Sovereign would be somewhat different. Foreign Sovereign Counterparties do not fall within the scope of this memorandum.

Operating the close out netting provisions of the ISDA Master Agreement and the default provisions in Paragraph 6 of the English Transfer Annex in order to determine a net close out amount under Section 6(e) of the ISDA Master Agreement in relation to the Crown following an Event of Default in relation to the Crown would not require the involvement of a court. However, if an English court were asked to consider the enforceability of this determination against the Crown acting through the Treasury, the English Court would find that the determination was enforceable subject to the assumptions and qualifications in this memorandum and the assumptions and qualifications that apply in Part V of the ISDA Netting Opinion.

(b) Immunity from execution

In the case of a close-out amount payable by the Crown (calculated taking into account the Value of the Credit Support Balance in respect of the Crown), a further question would arise as to whether a judgment against the Crown given by an English court could be enforced against assets of the Crown in the United Kingdom. Under the Crown Proceedings Act 1947, no process of enforcement, including injunctive relief and specific performance,[363] can be invoked against the Crown. The waiver of immunity set out in Section 13(d) of the ISDA Master Agreement would therefore not have any effect for the purpose of enforcement. As the duty to comply with a court order is imposed by statute, it has been suggested that, in the unlikely event that the Crown did not honour the order, a mandatory order might be issued to compel the Chancellor of the Exchequer, as the relevant minister, to comply with his duty to pay the damages.[364]

2. Political risk

Inevitably when dealing with a Sovereign, including the Crown acting through the Treasury, a party will want to consider political risk. This is a large and complex topic, with a number of dimensions, of which the legal dimension is only one. Strictly speaking, political risk does not affect the principles outlined above.

It is, however, of course, possible that the Crown might repudiate its obligations under the ISDA Master Agreement or English Transfer Annex in whole or in part. It could not do so lawfully under the current state of the law, but taking effective enforcement action against the Crown in those circumstances could be more difficult for political reasons than in relation to a private sector Counterparty.

Similarly, the Crown could purport to transfer its rights and/or novate its obligations under individual Transactions to other entities, most likely owned or controlled by the UK government, with the effect of disrupting the mutuality of obligations under the ISDA Master Agreement and altering the close-out calculation under Section 6(e) which would also affect the operation of the English Transfer Annex.

We are not aware of any specific legislation currently in effect under which the Crown could take any of the above actions lawfully, but the risk always exists that the Crown could implement emergency legislation giving itself such powers. For instance in the aftermath of the collapse of Northern Rock, the Banking (Special Provisions) Act 2008 was passed on an emergency basis which conferred significant property transfer powers (among other powers) on the Treasury in relation to English banks. Similarly, the Crown could pass legislation retrospectively invalidating the ISDA Master Agreement or the English Transfer Annex in whole or in part, including the close-out netting provisions of the ISDA Master Agreement which would impact the English Transfer Annex.

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363 Section 21(1) of the Crown Proceedings Act.

364 See W Wade and CF Forsyth, *Administrative Law* (11th edn, OUP 2014) 530.

These risks exist whenever a party is dealing with a Sovereign, and a party might prudently conclude that, in relation to the United Kingdom, the risk of the Crown taking any such action in relation to an existing agreement, in preference to honouring its obligations under such agreement in full, is remote, given the disastrous effect that any such action would have on its ability to access the financial markets or more generally on its reputation as a stable political democracy and leading industrialised nation. Furthermore, in the case of any legislative action that could be characterised as expropriating a party, the party could have redress against the United Kingdom under the European Convention on Human Rights.

Finally, instead of an act selectively affecting the ISDA Master Agreement or English Transfer Annex between a party and the Crown (or a broader class of agreements of which the ISDA Master Agreement and English Transfer Annex between that party and the Crown forms part), the Crown could declare a moratorium on repayment of its debt, impose exchange controls or take another general action that might affect its performance of its obligations under the ISDA Master Agreement or English Transfer Annex. The legality of any such action would need to be considered in light of the specific action taken and the legislative basis for such action invoked in the particular case, but again these are risks of a political nature that may arise when dealing with a Sovereign or, indeed, with any party within a particular jurisdiction where a Sovereign may take such actions. Accordingly, while these risks may be borne in mind, it seems reasonable to assume that they are remote in relation to the United Kingdom.