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

Validity and Enforceability under English Law of Close-out Netting
under the 2002, 1992 and 1987 ISDA Master Agreements

~~30 December 2015~~23 June 2017

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I. INTRODUCTION

1. Overview and scope of issues covered by this memorandum

This memorandum of law considers the validity and enforceability under English law[1] of close-out netting of privately negotiated[2] derivatives transactions (each, a **Transaction**) entered into under 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**):

(a) the ISDA 2002 Master Agreement (the **2002 Agreement**);

(b) the 1992 ISDA Master Agreement (Multicurrency – Cross Border) (the **1992 Agreement**);[3] and

(c) the 1987 ISDA Interest Rate and Currency Exchange Agreement (the **1987 Agreement**).[4]

References below to "the **ISDA Master Agreement**" or "an **ISDA Master Agreement**" apply equally, unless context otherwise requires, to the 2002 Agreement, the 1992 Agreement and the 1987 Agreement. Where a distinction between the forms of ISDA Master Agreement is relevant to the analysis, we refer expressly to the relevant form of ISDA Master Agreement. In addition, you have asked us specifically to comment on certain differences between the 1992 Agreement and the 2002 Agreement, which we do in part VI of this memorandum. In part VII of this memorandum we summarise specific issues raised by the 1987 Agreement.

In particular, we consider the validity and enforceability of the close-out netting provisions of the ISDA Master Agreement against each type of entity (each a **Counterparty**) specified in part I.3 below in the event of insolvency proceedings in England in relation to that type of Counterparty.

We also consider the validity and enforceability of the ISDA Master Agreement under English law in the absence of insolvency proceedings in relation to either party.

We refer to the update request email sent on ~~12 August 2015~~9 September 2016 attaching the instruction letter (together, the **Instruction Letter**) setting out the terms on which we are asked to advise. The issues that you have asked us to address are set out below in italics, followed in each case by our analysis and conclusions. A capitalised term used in this memorandum without definition has, unless the context indicates otherwise, the meaning given to that term in the ISDA Master Agreement.

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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 Also sometimes referred to as "over-the-counter" or "OTC" derivatives transactions

3 In 1992 ISDA also published the 1992 ISDA Master Agreement (Single Currency – Local Jurisdiction), designed for use between parties each of whom is operating from the same jurisdiction and transacting exclusively in the currency of that jurisdiction. For convenience, we deal expressly in this memorandum only with the much more widely used 1992 Agreement, designed for cross-border and multicurrency transactions, however our conclusions in relation to the 1992 Agreement apply *mutatis mutandis* to the single currency form.

4 In 1987 ISDA also published the 1987 ISDA Interest Rate Swap Agreement, designed for use only with US Dollar interest rate swap and similar transactions. For convenience, we deal expressly in this memorandum only with the more widely used 1987 Agreement, designed for cross-border and multicurrency transactions, however our conclusions in relation to the 1987 Agreement apply *mutatis mutandis* to the US Dollar form.

This memorandum (other than in Part XII 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.

2. Scope of Transaction types covered by this memorandum

You have asked us to advise on the validity and enforceability of the termination, close-out netting and multibranch netting provisions of the ISDA Master Agreement on the basis that the only Transactions governed by the ISDA Master Agreement are Transactions of a type falling within one or more of the types of transaction described in Appendix A. We assume that any Transactions entered into under a 1987 Agreement are entirely cash-settled.

3. Scope of Counterparty types covered by this memorandum

In this memorandum, we consider the enforceability of the ISDA Master Agreement against each type of English entity specified below and, to the extent indicated in part I.3(d) below, certain foreign entities.

(a) *English entities*

You have asked us to consider in this memorandum the following types of Counterparty described in Appendix B:

(i) a Corporation, if registered as a company in England under the Companies Act 2006[5] 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**);[6]

(iii) a registered society under the Co-operative and Community Benefit Societies Act 2014 with its registered office in England (a **C/CB Society**);[7]

(iv) a body corporate established by private Act of Parliament with its principal place of business in England (a **Statutory Corporation**);[8]

5 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 a "overseas companies" in the Companies Act 2006) registered as such under Part 34 of the Companies Act 2006.

6 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.

7 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.

8 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~~memorandum 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). We do, however, separately consider the Board of the Pension Protection Fund (as to which see Annex 14) in the context of our analysis in respect of an English Pension Fund.

(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**);

(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**);[9]

(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**));[10]~~;~~

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

(xi) an Insurance Company, if authorised by the Prudential Regulation Authority (the **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) a 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[11] and established either as ~~a trust governed by~~an English ~~law~~Trust (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):

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

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

11 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".

(i) an English Company;[12]

(ii) a Friendly Society;

(iii) a C/CB Society;[13]

(iv) a Statutory Corporation; or

(v) a Chartered Corporation;

(xiii) the Trustee of an occupational pension scheme established as an English Trust (an **English Pension Fund**);

(~~xiii~~xiv) 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[14] (the **OEIC Regulations**) by the Financial Conduct Authority (the **FCA**) established and domiciled in England; or

(ii) ~~a trust~~an English Trust authorised as a unit trust scheme[15] (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**).[16]

(xv) a Partnership, if established as either:

(i) a firm of partners subsisting pursuant to the Partnership Act 1890 (a **General Partnership**);[17] or

(ii) a firm of partners which is registered in England under the Limited Partnerships Act 1907 (a **Limited Partnership**);[18]

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

13 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~~memorandum) (see paragraphs 26 and 27 of Schedule 3 of the Charities Act 2011).

14 SI 2001/1228.

15 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).

16 We do not consider Investment Funds organised as ~~Authorised Contractual Schemes~~authorised contractual schemes in this memorandum.

17 While a General Partnership is not a legal person and the correct terminology to refer to two or more partners acting together is a "firm", the phrase "General Partnership" is used in this memorandum for ease of reference.

18 A Limited Partnership (that is not a private fund limited partnership – see below) is a partnership with one or more limited partners with liability limited to the amount of capital or property they have advanced to the firm and one or more general partners with

(a General Partnership and a Limited Partnership, being each, an **English Partnership**).

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

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

(~~xvi~~xviii) the United Kingdom acting through Her Majesty's Treasury, which is a Sovereign,

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

(b) *Trusts and trustees under English law*

(i) Nature of a trust and the personal liability of ~~a~~the 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, where we analyse an English Trust in this memorandum, we consider the enforceability of close-out netting under an ISDA Master Agreement against ~~a~~the Trustee of ~~an~~the 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

Although ~~a~~the Trustee is personally liable for its obligations under a contract it enters into on behalf of the ~~trust~~English 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~~the 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,

unlimited liability for the debts of the firm. Notwithstanding the definition of 'Partnership' in Appendix B of this memorandum, for the purposes of this memorandum, a Limited Partnership may be a 'collective investment scheme' under section 235 of the Financial Services and Markets Act 2000 and, therefore, constitute an 'Investment Fund' as defined in Appendix B, and the Limited Partnership may also be designated a 'private fund limited partnership' under the Limited Partnerships Act 1907 as amended by the Legislative Reform (Private Fund Limited Partnerships) Order 2017 (SI 2017/514). A limited partner in a private fund limited partnership is under no obligation to contribute any capital or property to the partnership unless otherwise agreed between the partners and is not liable for the debts or obligations of the firm beyond the amount of the partnership property which is available to the general partners to meet such debts or obligations (see Limited Partnerships Act 1907, section 4). Further to note 16, however, we assume that the Limited Partnership is not an authorised contractual scheme under the Financial Services and Markets Act 2000. Subject to the foregoing, we assume that the Limited Partnership is not subject to a special regulatory regime. Again, while a Limited Partnership is not a legal person and the correct terminology to refer to two or more partners acting together is a "firm", the phrase "Limited Partnership" is used in this memorandum for ease of reference.

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~~the Trustee will be entitled to have recourse to the trust assets in order to meet its liabilities under an ISDA Master Agreement between the party and the Trustee. There are ways, however, in which ~~a~~the 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 the ISDA Master Agreement, including the close-out netting provisions, against the Trustee, in the absence of insolvency proceedings in England in respect of the Trustee (discussed in part V below) or after the commencement of such proceedings (discussed in Annex 5 in relation to the Trustee of an English Trust that is not subject to a special regulatory regime, in Annex 12 in relation to the Trustee of an English Charitable Trust, in Annex 14 in relation to the Trustee of an English Pension Fund and in Annex ~~15~~16 in relation to the Trustee of an Authorised Unit Trust).

In Appendix E to this memorandum, we set out various issues that are relevant to dealing with the Trustee of ~~a trust governed by~~an English ~~law~~Trust that do not go to the enforceability of the Trustee's contractual obligations under the ISDA Master Agreement 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~~the Trustee.

(iii) Trustees within the scope of this memorandum

~~A trust~~An English 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~~an English 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~~an English 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 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 has the necessary power and authority to enter into the ISDA Master Agreement and each Transaction under the relevant trust deed.

Further, by way of digression in respect of Trustees of an English Pension Fund, pursuant to section 32 of the Pensions Act 1995, a majority of the Trustees acting properly will bind the minority unless the rules of the English Pension Fund provide otherwise. The effect of this is that (in the absence of a provision to the contrary in the English Pension Fund's governing documentation), so long as a majority of the Trustees enter into the ISDA Master Agreement, all of the Trustees will be bound and the other party will have a personal claim against each individual Trustee.[19]

[19] Note that only the current Trustees at the time the ISDA Master Agreement is executed will be bound. Any Trustee appointed after the date the ISDA Master Agreement is executed will not be bound unless the ISDA Master Agreement is novated to the relevant new Trustee.

When a party deals with a private individual, including a private individual acting as a 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 close-out netting under the ISDA Master Agreement against a particular corporate Trustee, that there may be one or more private individual Trustees for the relevant ~~trust~~English Trust who may or may not be a party to the ISDA Master Agreement on behalf of that trust. Although, in relation to an English Pension Fund, we understand it is customary to have a sole corporate Trustee.

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

It is important to bear in mind that (subject, in the case of an English Pension Fund, to section 32 of the Pensions Act 1995 (discussed above)) only a Trustee that has entered into, or subsequently has expressly agreed to assume contractual obligations under, the ISDA Master Agreement is contractually bound to the other party to the ISDA Master Agreement. Although the ISDA Master Agreement 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 either directly or through an agent.

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

A retiring Trustee is not, by virtue of its retirement as a Trustee, relieved of its contractual obligations incurred on behalf of ~~the trust~~an English 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.

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 E, 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 E.

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 with one or more Trustees for a particular ~~trust~~English 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 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 will typically provide that either (i) the retiring Trustee will automatically be released from liability under the ISDA Master Agreement 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, then the ISDA Master Agreement 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~~the "Trustee", we are referring to each Trustee that is bound by the terms of a given ISDA Master Agreement 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 an ISDA Master Agreement under which there is more than one Trustee that has entered into, or subsequently assumed obligations and liabilities under, the ISDA Master Agreement on behalf of the relevant ~~trust~~English Trust.

(iv) Trusts within the scope of this memorandum

We note that an English Charitable Trust, an English Pension Fund 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 close-out netting under the ISDA Master Agreement against ~~a~~the Trustee ~~for the~~of an English Charitable Trust ~~or~~, an English Pension Fund or an Authorised Unit Trust, as the case may be.

In relation to an English Trust, other than an English Charitable Trust ~~or~~, an English Pension Fund or an Authorised Unit Trust, we assume that it is not subject to a specific regulatory regime that may affect the enforceability of close-out netting under the ISDA Master Agreement against ~~a~~the Trustee ~~for~~of 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, English Partnership 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.[~~17~~20]

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.[21] This memorandum does not extend to an English investment fund established in any other form including authorised contractual schemes, unauthorised unit trusts, investment trusts, common investment funds or common deposit funds (relating to charities, pension funds or any other sector).

This memorandum covers General Partnerships and Limited Partnerships but does not extend to limited liability partnerships, which are out-of-scope. We assume, for the purposes of this memorandum, that each of the individual partners in a General Partnership and the general and limited partners in a Limited Partnership are English Companies.

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[~~18~~] ~~and~~ [22], an educational establishment established under the Further and Higher Education Act 1992 and a European Public Limited-Liability Company (or Societas Europaea). 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 close-out netting 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.

~~17~~20 Insurers (Reorganisation and Winding Up) (Lloyd's) Regulations 2005 SI 2005/1998.

21 However, see note 18 in respect of Limited Partnerships.

~~18~~ ~~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.~~

22 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.

(d) *Foreign entities*

In relation to a corporate entity organised under a law other than English law (a **Foreign Entity**), we consider the enforceability of the ISDA Master Agreement, including the close-out netting provisions, against the Foreign Entity as a matter of English law on the assumption that no resolution action or insolvency proceedings have been commenced against the Foreign Entity in England or elsewhere and provided that the Foreign Entity is a Corporation, Bank/Credit Institution, Investment Firm/Broker Dealer or Hedge Fund/Proprietary Dealer. This is considered in part V of this memorandum.

In addition, in part IV of this memorandum we consider the validity and enforceability of the close-out netting provisions of the ISDA Master Agreement under English law against an English Branch of Bank F (as each of those terms is defined in part IV), which is a Bank/Credit Institution acting as a Multibranch Party under the ISDA Master Agreement, including the validity and enforceability of the close-out netting provisions in the event of insolvency proceedings in England against the English Branch and/or insolvency proceedings in Bank F's home jurisdiction (referred to as "Country H" in part IV of this memorandum). We also consider the application of the resolution regime in the Banking Act in certain cross-border circumstances in ~~Part~~part IV.

(e) *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~~including, without limitation, the trust deed in relation to ~~a trust~~an English Trust and the partnership agreement in relation to an English Partnership) or to legal or regulatory requirements/restrictions (for example in respect of ~~Authorised Unit Trusts~~credit institutions, investment firms, investment funds and insurance companies) that may affect the legality or validity of its entering into certain types of Transaction under 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.~~[19]~~[23] 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.~~[20]~~[24]

For the purposes of our consideration of the enforceability of close-out netting under the ISDA

~~19~~23 We note, however, that when considering these issues in relation to ~~a corporate~~the Trustee of an English Trust, 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. Similarly, in the case of an English Partnership, as discussed further at Annex 17, a firm acts through its members as agents. Accordingly, without limitation, the assumption at part V.2(a) (referred to below in this part I.3(e)) should, insofar as an English Partnership is concerned, be construed so as to assume that the general partner in respect of a Limited Partnership and the relevant partner in respect of a General Partnership entering into the ISDA Master Agreement and each Transaction on behalf of the English Partnership has the necessary capacity (power) to act as partner and to itself enter into the ISDA Master Agreement and each Transaction, possesses the requisite authority to so bind the firm and has taken all corporate and other action necessary (including, but not limited to, any action required in accordance with any partnership agreement) to authorise entry by it into the ISDA Master Agreement and each Transaction on behalf of the English Partnership. Linked to the question of authority we also assume that, in entering into the ISDA Master Agreement: (i) the general partner of the Limited Partnership is expressly described therein as acting "in its capacity as general partner on behalf of" the Limited Partnership, or words to similar effect; and (ii) the relevant partner of a General Partnership is expressly described therein as acting "in its capacity as partner on behalf of" the General Partnership, or words to similar effect. As discussed above, in relation to an English Trust, we consider the enforceability of the ISDA Master Agreement against the Trustee of the trust and we discuss the position regarding the Trustee's recourse to the assets of the trust at Appendix E. For completeness, however, we assume that the Trustee has the necessary capacity to act as trustee and to enter into the ISDA Master Agreement and each Transaction thereunder on behalf of the English Trust and has taken all action necessary to authorise entry by it into the relevant ISDA Master Agreement and each Transaction on behalf of the English Trust.

~~20~~24 For example, in respect of English Building Societies, see the restrictions in section 9A of the Building Societies Act 1986.

Master Agreement (which is the principal purpose of this memorandum) under English insolvency law, we have assumed in part III.2(g) of this memorandum that each of the obligations of the parties are legal, valid and binding as a matter of contract under the relevant governing law, whether the parties have chosen English law or the law of the State of New York.

We then consider the basic contractual position in relation to an ISDA Master Agreement governed by English law in part V of this memorandum. In part V.2(a) we assume that each party is able lawfully to enter into and has taken all corporate action necessary to authorise entry into the relevant ISDA Master Agreement and each Transaction under that ISDA Master Agreement.[25]

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.[26] 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.

4. Structure of this memorandum

Part II summarises our conclusions on the principal questions raised by the Instruction Letter.

Part III responds to the questions in the Instruction Letter under the heading "Close-out ~~netting under~~Netting Under the ISDA Master Agreements" in relation to a Counterparty that is an English Company, other than an English Bank, an English Investment Firm, a Banking Group Company or Bank Holding Company, ~~an~~the Trustee of an English Trust, an English Insurance Company or an English Charity. These questions are then considered in annexes to this memorandum in relation to additional types of Counterparty, as specified in part III.1 below.

We have noted above that an English Insurance Company and an English Charity may each be established in one of a number of different legal forms of body corporate, in particular, as an English Company, Friendly Society, C/CB Society, Statutory Corporation or Chartered Corporation. As each of these different legal forms of body corporate is subject to a different insolvency regime, we first consider each of these forms separately and then consider whether and, if so, how the analysis is affected by law or regulation applicable to English Insurance Companies or English Charities, as the case may be.

An English Charity may also, as noted above, be established as an English Charitable Trust. An English Investment Fund may be organised as an Authorised Unit Trust, which is also a form of English Trust. We also consider English Pension Funds. In relation to such entities, we therefore consider the general position in relation to the enforceability of close-out netting

25 See note 23 in relation to the Trustee of an English Trust and an English Partnership.

26 For instance, in relation to a Friendly Society, we do not consider the powers under Part VIII of the Friendly Societies Act 1992 to transfer engagements of the Friendly Society. Similarly, in relation to a C/CB Society, we do not consider the powers under Part 9 of the Co-operative and Community Benefit Societies Act 2014 to transfer engagements of the C/CB Society. In the latter case, the power is expressly stated to not prejudice the rights of creditors (see section 110(4) of the Co-operative and Community Benefit Societies Act 2014).

under the ISDA Master Agreement against ~~a~~the Trustee of an English Trust that is not subject to a special regulatory regime and then consider whether and, if so, how the analysis is affected by law or regulation applicable to an English Charity, English Pension Fund or English Investment Fund.

We also consider (a) an English Investment Fund established as an Open-Ended Investment Company, (b) an English Partnership, (c) Standard Chartered Bank, (~~c~~d) the Bank of England and (~~d~~e) the United Kingdom acting through Her Majesty's Treasury.

Part IV addresses the questions raised in the Instruction Letter under the heading "Close-out Netting for Multibranch Parties".

Part V addresses the validity and enforceability under English law of the ISDA Master Agreement, including the close-out netting provisions, in the absence of insolvency proceedings or resolution action in relation to either party, including in the case of a Counterparty that is a Foreign Entity.

The remaining parts of this memorandum deal with additional matters raised by the Instruction Letter.

5 The Insolvency (England and Wales) Rules 2016

The Insolvency (England and Wales) Rules 2016[27] came into force[28] on 6 April 2017, replacing the Insolvency Rules 1986. There is a degree of uncertainty surrounding how certain insolvency procedures considered in this memorandum, that operate or did operate by reference to the Insolvency Rules 1986 or by reference to rules in analogous terms, should now be interpreted and we await further clarification in this regard. The same is true in respect of the plethora of secondary legislation that makes reference to the Insolvency Rules 1986. Some subordinate legislation[29] is in force that explicitly maintains the application of the Insolvency Rules 1986 and the Insolvency Act 1986 (as in force on 5 April 2017) to certain specialist insolvency regimes that are outside the scope of this memorandum and amends other secondary and primary legislation to replace references to the Insolvency Rules 1986 with references to the Insolvency (England and Wales) Rules 2016. It is not clear, however, whether further amending legislation will be made or if reliance is to be placed on the Interpretation Act 1978 to supplant the new Rules into the body of secondary legislation. We return to this theme in context at various points throughout this memorandum. This ambiguity, though unwelcome, does not in our view affect the conclusions reached in this memorandum.

It is worth mentioning, in this context and at the outset of this memorandum, the "Dear Insolvency Practitioner" letter (Issue 76 – April 2017) concerning the Insolvency (England and Wales) Rules 2016 (the **Dear IP Letter**) issued by the Insolvency Service. The Dear IP Letter states, in relation to 'financial institutions', that it is the intention of the Government to bring forward a further statutory instrument to take account of the general corporate insolvency reforms which came into force in April 2017 and, in the interest of "maintaining the coherence of the current legislation relating to the insolvency of financial institutions", the statutory instrument will disapply the reforms for the majority of HM Treasury's modified insolvency

27 SI 2016/1024. The Insolvency (England and Wales) Rules 2016 were amended by the Insolvency (England and Wales) (Amendment) Rules 2017 (SI 2017/366) with effect 6 April 2017.

28 Subject to transitional and savings provisions.

29 See the Insolvency (England and Wales) Rules 2016 (Consequential Amendments and Savings) Rules (SI 2017/369) and the Deregulation Act 2015 and Small Business, Enterprise and Employment Act 2015 (Consequential Amendments) (Savings) Regulations (SI 2017/540)

regimes while their impact is assessed and decisions are made about implementation. No such statutory instrument has yet been made.

II. SUMMARY OF CONCLUSIONS

On the basis of the analysis, assumptions and qualifications in this memorandum, our conclusions are that:

1. Assuming that the parties have not elected for the Automatic Early Termination provision of Section 6(a) of the ISDA Master Agreement to apply to an English Counterparty, the provision in Section 6(a) entitling a Non-defaulting Party to terminate outstanding Transactions by notice designating an Early Termination Date if an Event of Default has occurred and is then continuing against the English Counterparty would be valid and enforceable under English law against the English Counterparty in the event of insolvency proceedings in England in respect of the English Counterparty.

2. Assuming that the parties have elected for the Automatic Early Termination provision of Section 6(a) of the ISDA Master Agreement to apply to an English Counterparty, the Automatic Early Termination provision of Section 6(a) would be valid and enforceable under English law against the English Counterparty in the event of insolvency proceedings in England in respect of the English Counterparty.[~~21~~30]

3. The close-out netting provisions of the ISDA Master Agreement would be valid and enforceable under English law against an English Counterparty in the event of insolvency proceedings in England in respect of the English Counterparty.

4. In relation to an English Bank that is a Multibranch Party, our conclusion in 3 above would not be affected by the fact that the English Bank operated on a multibranch basis in jurisdictions where close-out netting is enforceable.

5. In relation to a Foreign Entity that is a Bank/Credit Institution and a Multibranch Party with an English Branch, (a) if it is an EEA credit institution, it may not be subject to separate insolvency proceedings or resolution action in England and (b) in any other case, any insolvency proceedings in England in relation to the Foreign Entity or its English Branch would be conducted, as far as a possible, on a universal basis without ring-fencing of local assets for local creditors. Following recognition of Third Country Resolution Action, resolution ~~proceedings~~action may be brought in England in respect of a foreign Bank/Credit Institution that is not an EEA credit institution. The Third Country Resolution Action once recognised may also take effect in England. Alternatively, resolution action may also be taken in England in respect of the UK branch of such a Third Country Institution independently of Third Country Resolution Action in certain circumstances.

6. In the absence of insolvency proceedings and resolution action in relation to a Counterparty, including a Counterparty that is a Foreign Entity within the scope of this memorandum, the provisions of the ISDA Master Agreement, including the close-out netting provisions, would be valid and enforceable under English law against the Counterparty.

7. The inclusion of the 2001 ISDA Cross-Agreement Bridge (the **2001 Bridge**) or the 2002 ISDA Energy Bridge (the **2002 Bridge**) in the Schedule to an ISDA Master Agreement would not materially affect the conclusions in paragraphs 1 to 6 above.

8. The amendment of a 1992 Agreement by the Close-out Amount Protocol published by ISDA on 27 February 2009 (the **Close-out Amount Protocol**) would not materially affect the conclusions in paragraphs 1 to 7 above.

[~~21~~30] In respect of the Bank of England, we think it is unlikely that it could be subject to insolvency proceedings and it is not possible to institute formal insolvency proceedings against the United Kingdom acting through Her Majesty's Treasury. In this regard, see also the discussion in respect of the PPF Board at Annex 14.

9. The amendment of an ISDA Master Agreement by the June 2014 Amendment to the ISDA Master Agreement in relation to Section 2(a)(iii) (the **June 2014 Section 2(a)(iii) Amendment**) would not materially affect the conclusions in paragraphs 1 to 8 above.

III. CLOSE-OUT NETTING UNDER THE ISDA MASTER AGREEMENT

1. Introduction

(1) *Scope*

In this part III, we consider the validity and enforceability under English law of the close-out netting provisions of the ISDA Master Agreement against an English Company in the event of insolvency proceedings in England in respect of the English Company.

Our conclusions in this part III apply in relation to an English Counterparty that is:

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

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

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

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

(v) the Trustee of an English Trust (other than the Trustee of an English Charitable Trust, an English Pension Fund, an English Authorised Unit Trust or any English Trust excluded from the scope of this memorandum under part I (3)(b) above), as modified and supplemented by Annex 5;

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

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

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

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

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

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

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

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

(xiv) the Trustee of an English Pension Fund, as modified and supplemented by Annex 14;

(~~xiv~~xv) an English Investment Fund that is an Open-Ended Investment Company, as modified and supplemented by Annex ~~14~~15; ~~and~~

(~~xv~~xvi) an English Investment Fund acting through the Trustee of an Authorised Unit Trust, as modified and supplemented by Annex ~~15.~~16; and

(xvii) an English Partnership, as modified and supplemented by Annex 17.

You have also asked us to consider in this memorandum the enforceability of the close-out netting provisions of the ISDA Master Agreement against each of the Bank of England 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.

For reasons discussed in more detail in Annex ~~16~~18 in relation to the Bank of England and Annex ~~17~~19 in relation to the United Kingdom acting through Her Majesty's Treasury, neither may, in our view, be made subject to insolvency proceedings in England. Therefore, the questions in this part III, which deal with the enforceability of the close-out netting in the event of insolvency proceedings, are not relevant to either of these Counterparties. The reasons for this in each case and additional issues that are relevant to each of these Counterparties are discussed in Annexes ~~16~~18 and ~~17~~19, respectively.

(2) *Meaning of "close-out netting provisions"*

In this memorandum, the term "close-out netting provisions" in relation to an ISDA Master Agreement refers to the provisions of the ISDA Master Agreement that give effect to the process of close-out netting, where that process is commenced by the Non-defaulting Party (or occurs automatically if Automatic Early Termination applies) under the ISDA Master Agreement following an Event of Default in relation to the other party.[~~22~~31]

Close-out netting following a default under any master netting agreement is a process comprised of three steps:

(a) early termination[~~23~~32] of transactions by reason of the default, either on notice given by the non-defaulting party or automatically (where so provided);

(b) valuation of the terminated transactions, normally by reference to the market value and normally determined by, and from the perspective of, the non-defaulting party at or about the time of termination; and

(c) determination of a net balance, representing the net market value of the terminated transactions, resulting in an amount which is then normally payable to the party in favour of whom the net balance runs, together with interest (if applicable) and any amounts that came due prior to the default and remain unpaid.

Note that this definition is consistent, for example, with the definition of "close-out netting provision" in Regulation 3 of the Financial Collateral Arrangements (No. 2)

[~~22~~31] Substantially the same process may be commenced following the occurrence of a Termination Event under the ISDA Master Agreement, however we are concerned in this memorandum principally with the operation of close-out netting following the occurrence of the Bankruptcy Event of Default, and therefore our discussion of close-out netting is limited to the case of a default.

[~~23~~32] Including early termination by acceleration, although whether the early termination is formally an acceleration will depend on the drafting of the contract providing for close-out netting. Under a securities repurchase (repo) master agreement, this step would normally be an acceleration of contractual obligations under the individual repo transactions governed by the master agreement. That would not, however, be the case in relation to the ISDA Master Agreement, for reasons discussed in more detail in the text below.

Regulations 2003 (the **FCA Regulations**),[~~24~~33] which implements Directive 2002/47/EC on financial collateral arrangements (the **Collateral Directive**), where the definition of "close-out netting provision" appears in Article 2(1)(n).

Relating this to the ISDA Master Agreement:

(i) early termination is governed by Sections 5(a), 6(a) and 6(c);

(ii) valuation of the Terminated Transactions is governed by Section 6(e); and

(iii) determination of a net balance is governed by Section 6(e), with the amount determined under Section 6(e) then becoming payable under Section 6(d).

In relation to (i), Section 5(a) sets out the Events of Default, including most importantly for present purposes, the Bankruptcy Event of Default, the occurrence of which is a pre-condition to early termination under Section 6(a). Section 6(a) governs the circumstances in which early termination may occur by notice given by the Non-defaulting Party designating an Early Termination Date or, where the parties have elected that Automatic Early Termination will apply in relation to a party, in which an Early Termination Date may be deemed to occur automatically as a result of the occurrence in respect of that party of certain specified events falling within the Bankruptcy Event of Default. Section 6(c) sets out the effect of the designation or deemed occurrence of an Early Termination Date.

In relation to (i), (ii) and (iii), certain definitions in the preamble to the ISDA Master Agreement and in Section 14 are used in these provisions, and other provisions of the ISDA Master Agreement are also relevant for certain purposes, for example, Section 9(h)(ii) of the 2002 Agreement, which governs interest accruing on Unpaid Amounts and on Early Termination Amounts from the Early Termination Date until the date of payment.

Section 1(c) (Single Agreement) expresses the intention of the parties that all Transactions are entered into in reliance on the fact that the ISDA Master Agreement and all Confirmations evidencing Transactions under the ISDA Master Agreement form a single agreement between the parties and that the parties would not otherwise enter into any Transactions.

Collectively, Sections 1(c), 5(a), 6(a), 6(c), 6(d), 6(e), related definitions in Section 14 and, where relevant, other provisions of the ISDA Master Agreement, are the close-out netting provisions of the ISDA Master Agreement.

(3) *Distinction between close-out netting and set-off*

Certain provisions of English and European legislation refer to close-out netting (sometimes just to "netting" or "netting agreements" or "netting arrangements", but normally meaning close-out netting) and to set-off[~~25~~34] (or sometimes to one and not the

[~~24~~33] SI 2003/3226.

[~~25~~34] In relation to English legislation, for example, see section 48 of the Banking Act and Article 3 of the Banking Act 2009 (Restriction of Partial Property Transfers) Order 2009; and in relation to European legislation Articles 23 and 25 of Directive 2001/24/EC on the reorganisation and winding-up of credit institutions.

other[~~26~~35]). Analytically, they are distinct concepts. The distinction, however, sometimes causes confusion, and this is partly because the concepts in some contexts overlap.

As described above, close-out netting is a contractual process comprised of three steps, early termination,[~~27~~36] valuation and determination of a net balance.

Set-off, on the other hand, is a legal right, rule or principle permitting (or sometimes requiring) a debtor to discharge its debt by setting off a cross-claim owed to the debtor against the debt. There are various legal bases for set-off, including, under English law, equitable set-off, set-off in judicial proceedings under the Civil Procedure Rules, statutory set-off under the Insolvency (England and Wales) Rules ~~1986~~2016 in the event of winding up (under Rule ~~4.90~~14.25) or administration (under Rule ~~2.85~~14.24) and contractual set-off.

Contractual set-off may supply the third step in the contractual process of close-out netting, but it is not the only possible legal basis for the third step. As described in more detail below, we are of the view that the combined effect of Sections 6(a), (c) and (e) of the ISDA Master Agreement, and related definitions in Section 14, is to determine the net balance owing under Sections 6(d) and (e) by or to the Defaulting Party without the use of contractual set-off, other than to the limited extent that there are Unpaid Amounts that became payable to a party under Section 2(a)(i) and that remain unpaid as at the date the net amount due under Sections 6(d) and (e) is determined.

Other master netting agreements used in the financial markets also follow the approach to close-out netting reflected in the ISDA Master Agreement.[~~28~~37] Some other master agreements used in the financial markets, however, use contractual set-off to effect the third step in the contractual process of close-out netting, for example, in relation to securities sale and repurchase (repo) transactions and securities lending transactions.[~~29~~38] But the key point to remember is that it will not necessarily be the case that the third step will be effected by contractual set-off.

In addition, contractual set-off is used in contexts that would not fall within the description of close-out netting. The 2002 Agreement itself provides a good example. After a net amount is determined under Section 6(e), Section 6(f) of the 2002 Agreement gives the Non-defaulting Party a right of contractual set-off to permit it:

(a) where it owes the Early Termination Amount to the Defaulting Party, to set off any other amounts (whether or not arising under the 2002 Agreement and whether or not matured or contingent) owed to it by the Defaulting Party against the Early Termination Amount; and

(b) where it is owed the Early Termination Amount by the Defaulting Party, to set off the Early Termination Amount against any other amounts (whether or not

~~26~~35 See, for example, Article 6 of Regulation 1346/2000/EC on insolvency proceedings. There is no reference to "close-out netting" or "netting" in that Regulation.

~~27~~36 Or acceleration: see note ~~23~~32.

~~28~~37 For example, the 2004 Master Agreement for Financial Transactions published by the Banking Federation of the European Union, Sections 6(4) and 7(1).

~~29~~38 See, for example, paragraph 10(d) of the 2011 version of the SIFMA/ICMA Global Master Repurchase Agreement.

arising under the 2002 Agreement and whether or not matured or contingent) it owes to the Defaulting Party.

This contractual set-off right does not include the additional contractual steps of early termination and valuation. It would therefore not fall within the description of close-out netting as described above.

Although the 1992 Agreement does not contain a similar contractual set-off clause, it is common market practice to include such a clause in Part 5 of the Schedule to a 1992 Agreement.[~~30~~39]

(4) *Insolvency proceedings under English law*

The types of insolvency proceeding that may be commenced in England in relation to an English Company are:

(a) a winding up or liquidation (these terms are interchangeable) under the Insolvency Act 1986, which may be:

(i) compulsory, that is, by or subject to the supervision of the court; or

(ii) voluntary, that is, a creditors' voluntary liquidation;[~~31~~40]

(b) administration under the Insolvency Act 1986;

(c) a statutory arrangement with creditors, which may be:

(i) a voluntary arrangement under the Insolvency Act 1986; or

(ii) a scheme of arrangement under the Companies Act 2006; and

(d) administrative receivership.[~~32~~41]

~~30~~39 It is common, for example, for parties to include in Part 5 of the Schedule a set-off clause based on the model clause set out on page 56 of the User's Guide to the 1992 ISDA Master Agreements (1993 edition) published by ISDA or since the publication of the 2002 Agreement, section 6(f) of the 2002 Agreement. For a more detailed discussion of the distinction between close-out netting and set-off, see I Annetts and E Murray, "Set-off, Netting, and Alternatives to Security" in D Prentice and A Reisberg (eds), *Corporate Finance Law in the UK and EU* (Oxford University Press, Oxford 2011). See also S Firth, *Derivatives Law and Practice* (Release ~~27: May 2015~~32: December 2016, Sweet & Maxwell, London ~~2015~~2016), paras 5-066 – 5-073. There is a helpful discussion in that work at para 5-073 of the decision of Lightman J in *Revenue and Customs Commissioners v Enron Europe Ltd* [2006] EWHC 824 (Ch); [2006] STC 1339, where the judge analyses the terms of a netting agreement not based on the ISDA Master Agreement, relating to physically-settled gas and electricity forward transactions.

~~31~~40 A members' (that is, shareholders') voluntary liquidation is possible under the Insolvency Act 1986, however it can only occur when the company is solvent, that is, able to pay its debts (including contingent and prospective debts) in full and the costs of the winding up in full within 12 months (see section 89 of the Insolvency Act 1986). It is therefore not considered an insolvency proceeding. If during the course of a members' voluntary liquidation, the liquidator forms the opinion that the company will not be able to pay its debts in full plus interest within the relevant period, the liquidation is converted to and proceeds as a creditors' voluntary liquidation.

~~32~~41 Prior to the Enterprise Act 2002, which came into force on 15 September 2003, administrative receivership was much more important as an insolvency procedure in England than it is currently. The Enterprise Act 2002 severely limited the ability of a floating charge holder to appoint an administrative receiver, meaning that, in relation to floating charges created on or after 15 September 2003, the majority of creditors will now have to rely instead on administration. Note also that receivership, other than administrative receivership, is not an insolvency proceeding in the strict sense. The receiver in the narrow sense has limited powers granted under a security document and under the Law of Property Act 1925 in relation to particular assets. It has no management powers in relation to the general assets of the company and no responsibility to consider the interests of creditors generally. An administrative receiver, strictly speaking, also has no responsibility to consider the interests of creditors generally, but the Insolvency Act 1986 imposes a number of additional obligations on an administrative receiver such as a duty of care to any other party having an interest in the equity of redemption and the requirements to (i) send a report to creditors and call a meeting of unsecured creditors and (ii) if the free assets of the insolvent are insufficient, pay preferential debts out of the proceeds of enforcement of the relevant floating charge. For this reason administrative receivership is properly treated as a type of insolvency procedure in the Insolvency Act 1986 and by insolvency practitioners. However, as already discussed, in light of changes introduced by the Enterprise Act 2002, administration has replaced administrative receivership for most purposes.

The types of insolvency proceeding that may be commenced (if any) in relation to each other type of English Counterparty are described in the Annex for that type.

In our analysis below in relation to close-out netting against an English Company, we deal in some detail with the two principal forms of corporate insolvency proceeding, namely, winding up and administration. We then deal more briefly with the other forms of insolvency proceeding that may apply to an English Company.

2. Assumptions

We have made the following assumptions:

(a) Two institutions enter into an agreement in the form of ~~the~~an ISDA Master Agreement, which is governed by New York law or English law (as selected by the parties). At least one of the institutions is an English Company (unless this part III is being read together with one of the Annexes hereto in which case at least one of the institutions will be the relevant entity covered by the relevant Annex). Neither institution has specified that it is a Multibranch Party. Issues arising when a party is acting as a Multibranch Party are considered in part IV of this memorandum below.

(b) The Counterparty and the other party are either professional dealers in privately negotiated derivatives or sophisticated end-users, including for this purpose a large corporation or other regular participant in the wholesale market for privately negotiated derivatives, provided that in the case of the Counterparty such party falls within the scope of this memorandum set out in part I.3 of this memorandum.

(c) No provision of the ISDA Master Agreement that is necessary for the giving of our advice in this memorandum has been altered in any material respect. In our view, no election contemplated by Sections 5 and 6 of the ISDA Master Agreement and made in a Schedule to that ISDA Master Agreement or in a Confirmation of a Transaction under that ISDA Master Agreement would be considered a material alteration for this purpose.

(d) The only Transactions governed by the ISDA Master Agreement are Transactions of a type falling within one or more of the types of transaction described in Appendix A. Some of the Transactions governed by the ISDA Master Agreement are cash-settled, meaning that the obligations of each party are limited to payment obligations, while other Transactions are physically settled, meaning that at least one, if not both, parties have an obligation to deliver shares, bonds, commodities or other assets to the other party. The obligations of either party may be contingent on the occurrence of an event (for example, a market price exceeding an agreed strike price) and may be subject to one or more other conditions.[~~33~~42]

(e) In relation to the 1992 Agreement, the parties have elected Second Method to apply and, in relation to the 1987 Agreement, Section 6(e)(i)(1) has been amended *mutatis mutandis* so that its substantive effect is the same as Section 6(e)(i)(2), namely, to provide that the Non-defaulting Party[~~34~~43] shall pay the Defaulting Party where the

[~~33~~42] In addition to the conditions precedent in Section 2(a)(iii) of the ISDA Master Agreement.

[~~34~~43] The term "Non-defaulting Party" is not defined in the 1987 Agreement, but for convenience we use it to mean the party that is not the Defaulting Party under the 1987 Agreement.

Defaulting Party is "in the money" on a net basis (and after taking into account Unpaid Amounts).[~~35~~44]

(f) In relation to the 1987 Agreement, for the purposes of answering the question in part III.3(1) of this memorandum, the 1987 Agreement has been expressly amended to delete the second sentence of Section 6(a) providing for the deemed occurrence of an Early Termination Date in the case of a Bankruptcy Event of Default.[~~36~~45]

(g) The obligations of each party under the ISDA Master Agreement are legal, valid and binding under the relevant governing law, whether the parties have chosen English law or the law of the State of New York. We make this assumption in this part III because the courts of England will look to the governing law of the relevant contract to determine the basic contractual position before considering the effect of English insolvency law on that position. We discuss the basic contractual position under English law in relation to the ISDA Master Agreement, including the close-out netting provisions, in part V below. ~~Similarly, we assume that each~~

(h) Each of the parties to the ISDA Master Agreement 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 Transaction was entered into in consequence of a communication made in breach of section 21(1) of the Financial Services and Markets Act 2000.

(~~h~~i) In addition to the assumptions above, we make the following assumptions for reasons given in part III.3 below:

(i) Each of the parties is personally liable as principal for its obligations under the ISDA Master Agreement in relation to each Transaction and is beneficially entitled to its benefits under the ISDA Master Agreement in relation to each Transaction (in other words, there is full mutuality between the parties), and that no third party (an **Intervener**) has any interest in any right of either party under the ISDA Master Agreement or, if that is not the case, that no party has notice, on or prior to entry into the ISDA Master Agreement or into any Transaction under the ISDA Master Agreement, of the existence of any Intervener that has an interest in any right of the other party. The principal types of Intervener are an assignee, a chargee holding a crystallised floating charge, an attaching creditor, an undisclosed principal, an undisclosed beneficiary and a subrogated creditor.

(ii) The ISDA Master Agreement and each Transaction were entered into by each party prior to the occurrence of insolvency, resolution, rescue or composition proceedings in respect of either party. In particular, but without limiting the generality of the above, the ISDA Master Agreement and each Transaction were entered into by each party prior to:

~~35~~44 This is sometimes referred to as "Full Two-way Payments", due to drafting of the 1985 and 1986 versions of the ISDA Code of SWAPS, although that term is not used in the 1987 Agreement.

~~36~~45 This is referred to as Automatic Early Termination in the 1992 Agreement and the 2002 Agreement, but this term does not appear in the 1987 Agreement.

(A) the commencement of winding up proceedings or administration in respect of either party; or

(B) either party having notice ~~of a meeting of creditors~~that a decision has been sought from creditors on the nomination of a liquidator under section ~~98~~100 of the Insolvency Act 1986 or of a petition for winding up in respect of the other party; or

(C) either party having notice of an application for an administration order or notice of an intention to appoint an administrator in respect of the other party; or

(D) in the case where a winding up is immediately preceded by an administration ~~which commenced after 15 September 2003~~ in respect of the other party:

(1) the administration; or

(2) the other party having notice of an application for an administration order or notice of an intention to appoint an administrator in respect of that party; or

(E) in the case where an administration ~~order~~ is immediately preceded by a winding up in respect of either party:

(1) the commencement of the winding up proceedings; or

(2) the other party having notice ~~of a meeting of~~that a decision has been sought from creditors under section ~~98~~100 of the Insolvency Act 1986 on the nomination of a liquidator or of a petition for a winding up in respect of that party.[~~37~~46]

(iii) Neither party is insolvent at the time of entering into the ISDA Master Agreement including each Transaction or becomes insolvent as a result of entering into such documents. In particular, at the time each party enters into the ISDA Master Agreement and each Transaction:

(A) it is able to pay its debts within the meaning of section 123 of the Insolvency Act 1986, and it does not become unable to pay its debts as a consequence of entering into the ISDA Master Agreement or such Transaction;[47]

[~~37~~46] These cut-off dates are based on ~~Rule 2.85~~Rules 14.24 and ~~4.90~~14.25 of the Insolvency (England and Wales) Rules ~~1986~~2016. In respect of the English Counterparties covered by the Annexes to this memorandum, alternative insolvency rules apply in some cases. We note, in particular here, the discussion at part I.5 above. We assume in such cases that the ISDA Master Agreement and each Transaction were entered into by each party prior to any cut-off date for eligibility of claims for any analogous insolvency set-off rule applicable pursuant to insolvency proceedings in respect of the relevant English Counterparty.

[47] We also assume, where applicable, that each party is able to pay its debts within the meaning of sections 222-224 of the Insolvency Act 1986 and does not become unable to pay its debts within the meaning of those sections as a consequence of entering into the ISDA Master Agreement or any Transaction.

(B) the terms of the ISDA Master Agreement and each Transaction have been agreed at arms' length by the parties so that no element of gift or undervalue from one party to the other party is involved; and

(C) in deciding to enter into the ISDA Master Agreement and each Transaction or to make any payment or delivery under the ISDA Master Agreement or any Transaction, 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 if the ISDA Master Agreement or such Transaction had not been entered into or such payment or delivery had not been made.

(~~i~~j) The Counterparty has its centre of main interests (**COMI**) for purposes of the EC Insolvency Regulation[~~38~~48] in England. 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.[~~39~~49]

3. Questions relating to Close-out Netting under the ISDA Master Agreement

(1) *Assuming the parties have not selected Automatic Early Termination upon certain insolvency events to apply to the insolvent counterparty organised in your jurisdiction, are the provisions of the ISDA Master Agreement permitting the Non-defaulting Party to terminate all the Transactions upon the insolvency of its counterparty enforceable under the law of your jurisdiction?*

Under the first sentence of Section 6(a), if an Event of Default occurs in relation to a party, the Non-defaulting Party is entitled to give a notice to the Defaulting Party designating an Early Termination Date in relation to all Transactions then outstanding.

In a case where the parties have not specified in the Schedule to the ISDA Master Agreement that Automatic Early Termination applies in relation to the Defaulting Party, the right of the Non-defaulting Party to designate an Early Termination Date extends to the occurrence of any Event of Default falling within Section 5(a)(vii), including those Events of Default that would otherwise have triggered Automatic Early Termination had it been elected by the parties in relation to the Defaulting Party.

Once the Non-defaulting Party has given notice under Section 6(a) designating an Early Termination Date, then under Section 6(c)(ii), upon the effectiveness of that notice, the obligations of each of the parties under all Transactions cease.

~~38~~48 Council Regulation 1346/2000/EC on insolvency proceedings [2000] OJ L160.

~~39~~49 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.

We believe that the notice termination provision of Section 6(a) would be enforceable under English law even in the event of voluntary or involuntary winding up proceedings in respect of the English Company. This statement is subject to the following:

(a) We believe that an English court would give effect to Sections 2(a)(iii) and 6(c) of the ISDA Master Agreement, which make performance of payment and delivery obligations in respect of individual Transactions conditional upon the fact that an Early Termination Date has not occurred or been effectively designated.

This should be the case regardless of whether those Transactions would, at the time of the insolvency of a party, have been categorised (apart from this conditionality) as executory contracts (either to exchange money or for the sale or purchase of securities or commodities) or reciprocal obligations to pay debts. In either case, the effect of the designation of an Early Termination Date under the ISDA Master Agreement is that no further payments or deliveries will be required to be made in respect of the Terminated Transactions. The obligation to pay or deliver in respect of a Transaction is therefore never anything more than a conditional obligation. The right to receive that payment or delivery is never anything more than a conditional right.

Termination is therefore arguably a misnomer in the context of the ISDA Master Agreement. Instead, the occurrence or effective designation of an Early Termination Date under Section 6(a) constitutes the absolute and permanent failure of one of the conditions to the parties' respective rights and obligations under the terms of individual Transactions. Since those obligations are created and defined by the terms of the ISDA Master Agreement, we believe an English court would give effect to the parties' intention that the obligations are subject to such a condition and, therefore, would give effect to the notice termination provision of Section 6(a).

In 2012 Lord Justice Longmore gave a unanimous judgment for the Court of Appeal in respect of a series of conjoined appeals, including *Lomas v Firth Rixson* each of which concerned the consequences of an Event of Default and the application of Section 2(a)(iii) of the 1992 ISDA Master Agreement.[~~40~~50] The Court of Appeal confirmed that the payment obligations of a Non-defaulting Party are suspended, as opposed to extinguished, by Section 2(a)(iii) until either the Event of Default or Potential Event of Default is cured or an Early Termination Date occurs. Furthermore, there is no implied term that limits the length of the suspension to a reasonable time period – see part XI below in respect of the June 2014 Section 2(a)(iii) Amendment.[~~41~~51]

(b) Even if the individual Transactions were, contrary to Section 1(c), viewed as separate contracts between the English Company and the other party, and leaving aside the effect of Section 2(a)(iii), the following analysis supports the enforceability of Section 6(a):

(i) In the case of Transactions that would be characterised as executory contracts, such Transactions are capable of termination on default, including on the insolvency of the English Company, in the manner provided in Section 6(a) of the ISDA Master Agreement. Although there appears to be only one case

~~40~~50 *Lomas v JFB Firth Rixson, Inc.* [2012] EWCA Civ 419.

~~41~~51 Note that the ability of a Non-defaulting Party to rely on Section 2(a)(iii) of the ISDA Master Agreement as a condition precedent to its obligations under a Transaction without designating an Early Termination Date is not within the scope of this opinion.

directly on point,[~~42~~52] close-out rules providing for termination (rescission) of open contracts and accounting for subsequent losses and gains have been a feature of the rules of the stock exchange and of commodities and metal markets in London for many years. There have been numerous cases, notably in relation to stock exchange and produce exchange bankruptcies, dealing with the effects of close-outs on these markets. We know of no successful challenge in these cases to this right of close-out on the ground that termination of an executory contract to exchange money or for the sale or purchase of securities or commodities offended English insolvency law.

(ii) In the case of Transactions that would be characterised as contingent obligations to pay debts (for example, fully-paid options), termination is not an issue. The relevant debt is simply due, albeit at a future date and subject to one or more contingencies. To include contingent debts within the scope of close-out netting, it is simply necessary to provide a method for valuing such debts. This, as discussed below, is provided by Section 6(e) of the ISDA Master Agreement.

(iii) As a practical matter, "termination values" of each Transaction are available for close-out netting regardless of the characterisation of the Transaction. Therefore, even if an English court were to take the view (which we think unlikely) that a Currency Swap (as defined in Appendix A), for example, was not an executory contract but instead a contract for the payment of a series of reciprocal future debts, essentially the same result would be achieved.

(2) *Assuming the parties have selected Automatic Early Termination upon certain insolvency events to apply to the insolvent counterparty organised in your jurisdiction, are the provisions of the ISDA Master Agreement automatically terminating all the Transactions upon the insolvency of a counterparty enforceable under the law of your jurisdiction?*

Where the parties have elected Automatic Early Termination in relation to a party, Section 6(a) provides that an Early Termination Date will be deemed to have occurred upon the occurrence in respect of that party of certain events specified in Section 5(a)(vii), namely, clauses (1), (3), (4), (5), (6) or, to the extent analogous to any of the foregoing, (8). In relation to clause (4) of Section 5(a)(vii), Section 6(a) further provides that the Early Termination Date will be deemed to have occurred "immediately preceding the institution of the relevant proceeding or the presentation of the relevant petition". In other words, in relation to clause (4), the early termination of all Transactions will not only be automatic, but it will also have retrospective effect.

Section 6(c)(ii) provides that upon the deemed occurrence of an Early Termination Date, the obligations of each of the parties under all Transactions cease.

We believe that Automatic Early Termination, if elected to apply in relation to the English Company, would be enforceable under English law in the event of voluntary or involuntary winding up proceedings in respect of the English Company. This statement is subject to the following:

[~~42~~52] *Shipton, Anderson & Co (1927) Ltd v Micks, Lambert & Co* [1936] 2 All ER 1032 (where the court upheld a buyer's right to rescind a commodity contract on a seller's stoppage of payment under an express clause contained in the rules of the commodity market concerned).

(a) We believe that Automatic Early Termination would be enforceable because, if an express notice of termination clause is valid, there is no reason why the parties should not be able to agree to dispense with that notice.

(b) Although we believe that an English court would recognise the effectiveness of Automatic Early Termination, it is possible, although we consider this unlikely, that it would not give effect to the intended retroactive effect of the provision in relation to clause (4) of Section 5(a)(vii).

(c) If, contrary to our view, an English court were not to give effect to Automatic Early Termination, the Non-defaulting Party might be able to terminate by notice, by way of implied term, bearing in mind that Section 6(a) does not expressly provide a fallback to notice in the event that Automatic Early Termination is not effective. An argument could be made that had the parties not selected Automatic Early Termination, then the Non-defaulting Party would have had the right to terminate by notice so if Automatic Early Termination is not available there should be an implied right to terminate by way of notice.

(3) *Are the provisions of the ISDA Master Agreement providing for the netting of termination values in determining a single lump-sum termination amount upon the insolvency of a counterparty enforceable under the law of your jurisdiction?*

In this part III.3(3), we consider the enforceability under English law of the close-out netting provisions of the ISDA Master Agreement, which provide for the netting of termination values in determining a single lump-sum termination amount upon default of a party, in the event of insolvency proceedings in respect of an English Company.

First, we consider in some detail the enforceability of the close-out netting provisions in the event of the two most important forms of corporate insolvency proceeding, namely, winding up and administration. We then consider more briefly other forms of insolvency proceeding to which an English Company may become subject.

We consider the enforceability under English law of the close-out netting provisions of the ISDA Master Agreement in the event of insolvency proceedings in respect of each other type of English Counterparty covered by this memorandum in the relevant Annex.

(a) <u>Winding up or liquidation</u>

If a creditors' voluntary liquidation or a compulsory liquidation were commenced under the Insolvency Act 1986 in respect of an English Company, we believe that an English court would hold that the close-out netting provisions of Section 6 are enforceable and are not subject to material limitation or avoidance on the basis of any rule of insolvency law, other than in the limited circumstances where anti-avoidance rules relating to preferences and transactions at an undervalue might apply.

The anti-avoidance rules are discussed further below, but in any event will not apply on the basis of the assumptions ~~you have permitted us to make~~<u>herein</u>. Our conclusion as to the enforceability of Section 6 does not depend on whether the Early Termination Date occurs or is deemed to occur prior to, on or after the commencement of the winding up of the English Company.

There is a possibility that an English court would view the close-out netting provisions as a form of contractual set-off arrangement.[~~43~~53] In this case where the close-out netting does not occur before commencement of the liquidation, then it would be displaced by the statutory insolvency set-off provision of Rule ~~4.90~~14.25, which is mandatory, automatic, and self-executing (that is, does not require the liquidator or the creditor to take any procedural steps).[~~44~~54]

In this case, any obligations due between the Non-defaulting Party and the Defaulting Party in respect of any outstanding Transactions under the ISDA Master Agreement and any other amounts due under the ISDA Master Agreement (for example, in respect of default interest) would be included in the mandatory and automatic set-off under Rule ~~4.90~~14.25 along with any amounts due under any other "mutual dealings" between the parties. Thus, a net balance would be determined in relation to the ISDA Master Agreement, although, for reasons discussed below, it may differ in amount from the net close-out amount that would be determined in accordance with the terms of Section 6(e). We believe that the likelihood of an English court taking this view is remote.

We first set out in more detail why we believe that the close-out netting provisions would not (except in one limited sense) be viewed as a contractual set-off arrangement, and then consider the alternative analysis under which the close-out netting provisions would be displaced by Rule ~~4.90~~14.25.

Close-out netting and the single agreement concept

Section 1(c) provides that the ISDA Master Agreement together with all Confirmations documenting Transactions constitute a single agreement between the parties. We believe that there is no objection *per se* under English law to such a provision and therefore that the ISDA Master Agreement and all related Transactions may, subject to the considerations discussed below, be considered a single agreement between the parties for the purposes of English law.

We note that Section 6(c)(ii) provides that, upon the effectiveness of notice designating, or the deemed occurrence of, an Early Termination Date, the obligations of each party in respect of individual Transactions cease and instead a single amount becomes payable under Section 6(e).

Section 6(e) may therefore be viewed as a mere accounting between the parties that does not involve set-off (except, as discussed below, to the extent that it includes Unpaid Amounts). As discussed in part III.3(1) above, by virtue of the conditionality to which payment and delivery obligations under the ISDA Master Agreement are subject, a party to an ISDA Master Agreement never has more than a conditional entitlement to receive a payment or a delivery under the ISDA Master Agreement until the scheduled due date for performance of that obligation and only then if the conditions precedent in Section 2(a)(iii) are satisfied in relation to that due date.

In other words, the "asset" represented by each such entitlement may be said to be "flawed", from the point of view of the conditionally entitled party, in two ways. It is

[~~43~~53] Note that, in any event as discussed below, a set-off is applicable in a limited sense if there are Unpaid Amounts to include in the Section 6(e) calculation.

[~~44~~54] *National Westminster Bank Ltd v Halesowen Presswork & Assemblies Ltd* [1972] AC 785 (HL); *Stein v Blake* [1996] AC 243 (HL). See also, RM Goode, *Principles of Corporate Insolvency Law* (4th edn Sweet & Maxwell, London 2011), paras 9-13, 9-19.

subject to the conditions precedent in Section 2(a)(iii), which includes the condition that no Early Termination Date has occurred or been designated in relation to that party,[~~45~~55] and, more importantly, it is subject to the combined effect of Section 6(c)(ii) and Sections 6(d) and 6(e). For this reason, close-out netting under the ISDA Master Agreement is sometimes said to be based on the "flawed asset" approach. It is, however, important to bear in mind that Section 2(a)(iii) is not strictly necessary to give effect to the close-out netting under the ISDA Master Agreement. It provides important protection to a Non-defaulting Party during the period following the occurrence of an Event of Default or Potential Event of Default, but if it were disapplied, the close-out netting provisions would produce the same result following the occurrence or designation of an Early Termination Date.

In a case where an Early Termination Date has occurred or been effectively designated upon or following the occurrence of an Event of Default in relation to a party:

(i) the conditional entitlements of each party are discharged by Section 6(c)(ii), but without affecting any unconditional entitlement of a party to receive an amount that became due and payable prior to such occurrence or effective designation; and

(ii) a net amount becomes due under Section 6(e) determined in accordance with the provisions of Section 6(e)(i) (adjusted in accordance with Section 6(e)(iii), where applicable) and payable in accordance with the terms of Section 6(d).

The net amount is determined by the Non-defaulting Party under Section 6(e) by reference to the mark-to-market values of the Terminated Transactions. The methodology for determining the net amount varies somewhat between the 1992 and 2002 versions of the ISDA Master Agreement and, under the 1992 version, according to whether the parties have elected "Market Quotation" or "Loss" as the payment measure in the Schedule to the ISDA Master Agreement. These variations do not, however, affect our conclusions in relation to the enforceability of Section 6(e).

The question arises whether the flawed asset approach of Section 6(e) offends or is capable of offending the anti-deprivation rule (or principle) of English insolvency law. The anti-deprivation rule is a longstanding rule of English insolvency law to the effect that contractual terms purporting to dispose of property on bankruptcy may be invalid as a fraud on or evasion of bankruptcy law.[~~46~~56]

The leading authority on the anti-deprivation rule is the decision of the Supreme Court in *Belmont Park Investments PTY Limited v BNY Corporate Trustee Services Limited*.[~~47~~57] In that decision the Supreme Court upheld the validity of a "flip clause" in a Lehman Brothers structured finance transaction.

In light of the importance of the issues raised in the case not only for the structured finance transaction at issue but also for a wide variety of financing transactions that rely on clauses that take effect, in one form or another, upon the insolvency of a party,

~~45~~55 Section 2(a)(iii)(2) of the ISDA Master Agreement.

~~46~~56 We have considered the anti-deprivation rule in this section regarding winding up or liquidation but it should be noted that it was held in *Revenue and Customs Commissioners v Football League Ltd* [2013] BCC 60 that the same principle would apply in an administration once the administrator has given notice of his intention to make distributions to creditors.

~~47~~57 [2011] UKSC 38.

in *Belmont* the Supreme Court took the opportunity (as did the High Court and the Court of Appeal at earlier stages of the same case) to review the various strands of case law on the anti-deprivation rule with a view to reconciling the authorities and clarifying the scope and operation of the rule.

During the course of the judgment, the Supreme Court made clear that a "flawed asset" (that is, flawed by reference to the solvency of the owner of the asset) is not necessarily immune from the application of the anti-deprivation rule nor is a provision imposing an obligation limited by the condition that the obligee not be subject to insolvency proceedings.[~~48~~58]

It is, however, equally clear that such clauses are not *per se* violations of the anti-deprivation rule. Instead, the Supreme Court, in the majority judgment given by Lord Collins, establishes the principle that such a clause does not violate the anti-deprivation rule if it forms part of a commercial transaction entered into in good faith and which does not have as its predominant purpose, or one of its main purposes, the deprivation of the property of one of the parties on bankruptcy.[~~49~~59] Lord Collins characterised this is as a substance over form approach.[~~50~~60] It should not be the case that whether or not the rule applies turns purely on a question of drafting.[~~51~~61]

Whether the anti-deprivation rule as formulated in *Belmont* provides sufficiently certain guidance for all of the various contexts in which flawed assets and conditional clauses are used in financial market documentation is debatable. The Supreme Court does, however, review a number of the existing authorities in light of its delineation of the basic principles, and this helps shed further light on how the rule, following *Belmont*, should be interpreted in at least some types of cases.

In addition, the Court of Appeal's decision in *Lomas v Firth Rixson*[~~52~~62] addressed whether Section 2(a)(iii) of the 1992 ISDA Master Agreement breached the anti-deprivation rule. The Court of Appeal followed the approach outlined by Lord Collins in *Belmont* in respect of the application of the anti-deprivation rule and found on the facts of the relevant appeal that Section 2(a)(iii) in that instance could not be said to have breached the anti-deprivation rule. Longmore LJ helpfully also noted that one should assess the commerciality of Section 2(a)(iii) in relation to its operation throughout the life of the contract and not merely at the time it is invoked.[~~53~~63]

We are of the view that the combined effect of Sections 1(c), 2(a)(i), 2(a)(iii), 6(c)(ii), 6(d) and 6(e) and related definitions in Section 14 (which is often referred to in the market as the "single agreement" approach) is clearly capable of satisfying the *Belmont* test, that is, forming part of a commercial transaction entered into in good faith and without the purpose of depriving the Defaulting Party of its property in the event of its insolvency. In a memorandum of this type, given on hypothetical facts, we must assume that the parties are entering into the ISDA Master Agreement in good faith, but we see no reason why that would not normally be the case.

[~~48~~58] ibid [89]-[91], [107], [163].
[~~49~~59] ibid [104], [108].
[~~50~~60] ibid [105].
[~~51~~61] ibid [87].
[~~52~~62] [2012] EWCA Civ 419, [2012] All ER (Comm) 107
[~~53~~63] ibid [86]-[87]

Moreover, we are of the view that the single agreement approach does not effect any deprivation. It produces a net balance that may not be identical to but is nonetheless likely to be broadly similar to the net balance determined on the basis of mandatory insolvency set-off under Rule ~~4.90~~14.25. In practice, of course, the net balance may be more or less favourable to the Defaulting Party, but *ex ante* it could be either. We do not see, therefore, how it could be said to be an approach entered into by the parties with a purpose (much less a predominant purpose) of depriving an insolvent Defaulting Party of its property. We do not believe that an English court would conclude that Section 6(e) effected a deprivation of the property of the Defaulting Party simply because, looked at in hindsight, it produced a result less favourable to the Defaulting Party than would have been the case under Rule ~~4.90~~14.25.

Technically, of course, the operation of Section 6(c)(ii) does deprive the Defaulting Party of the benefit of all of the obligations that are owed (or would, but for Section 2(a)(iii), have been owed) to it by the Non-defaulting Party. However, this effect is linked to the calculation of an amount under Section 6(e) that in economic terms represents the net balance of the rights owed to and obligations owed by the Defaulting Party.

There is therefore no diminution of the estate of the Defaulting Party by the operation of Section 6(c)(ii) when read together with Section 6(e) and the other provisions of the ISDA Master Agreement constituting the single agreement approach. A longstanding defence to application of the anti-deprivation rule is that the insolvent company has received fair value for the asset which is allegedly deprived.[~~54~~64] What Section 6(c)(ii) takes away, Section 6(e), in effect, restores.

In light of the foregoing, we are of the view that the close-out netting provisions of the ISDA Master Agreement do not violate the anti-deprivation rule.

The *pari passu* rule (which is related to but distinct from the anti-deprivation rule) provides that parties may not contract out of the statutory scheme for the distribution of the property of an insolvent person.[65] This was also considered in *Lomas v Firth Rixson* by Longmore LJ who found that there is no relevant property capable of being distributed to which the rule could apply because Section 2(a)(iii) prevents a debt from being payable due to the unsatisfied condition precedent.

Subject to the discussion below of the anti-avoidance rules in the Insolvency Act 1986, we are of the view that there is no other rule of English insolvency law that would prohibit or materially restrict or otherwise affect the operation of the close-out netting provisions of the ISDA Master Agreement. We are therefore of the view that the close-out netting provisions would be enforceable against an English Company in the event of its becoming subject to winding up proceedings under the Insolvency Act 1986.

The "one limited sense" referred to above in which even on the flawed asset approach the close-out netting provisions operate as a contractual set-off provision is that

~~54~~64 *Whitmore v Mason* (1861) 2 J&H 204; 70 ER 1031; *Borland's Trustee v Steel Bros & Co Ltd* [1901] 1 Ch 279.

65 For the sake of completeness, we note that the recent decision of the Supreme Court in *Re Lehman Brothers International (Europe) (In Administration) (and others)* [2017] UKSC 38 upheld the effectiveness of certain contractual subordination provisions which may, in effect, allow a creditor to contract out of the benefit of the *pari passu* principle.

Section 6(e) includes within the calculation Unpaid Amounts owed by either party that became payable prior to the operation of Section 6(c)(ii).[~~55~~66]

Close-out netting as a form of contractual set-off arrangement

Although we are confident that the close-out netting provisions of Section 6(e) of the ISDA Master Agreement would be enforceable under English law without having to consider them on the basis of insolvency set-off, we also think that they would be valid when considered on that basis.

If an Early Termination Date occurs on or after the commencement of a winding up of the English Company, then, as noted above, the close-out netting provisions, if viewed by an English court as effecting a contractual set-off, would be displaced by the automatic and mandatory operation of Rule ~~4.90~~14.25. This would result in the determination of a net balance owed by or to the Non-defaulting Party, although the quantum and timing of this net balance would~~, as already discussed,~~ not necessarily match the quantum and timing of the determination of the net balance due under Section 6(e). It is worth briefly noting here that, if the ISDA Master Agreement forms part of a financial collateral arrangement under the FCA Regulations, Regulation 12 provides that a close-out netting provision shall, subject to certain exceptions, 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 the discussion that follows we assume that the FCA Regulations are not applicable.

Before considering insolvency set-off, we need to consider the validity of the provisions in the ISDA Master Agreement for the determination of a termination value in respect of each Transaction.

We believe that the provisions of Section 6(e) of the 2002 Agreement that require the Non-defaulting Party to determine the Close-out Amount would be unobjectionable if performed in good faith, using commercially reasonable procedures to produce a commercially reasonable result in accordance with Section 6(e).

We also believe that the provisions of Section 6(e) of the 1992 Agreement that provide for a method of valuation by reference to Market Quotation or Loss would be unobjectionable if the Non-defaulting Party acts in a commercially reasonable manner and in good faith. This is the case whether the Transaction in respect of which a termination value is being sought is an executory contract or a contract constituting one or more contingent obligations to pay a future debt.

If we analyse the close-out netting provisions of the ISDA Master Agreement on the basis of insolvency set-off, we would argue that, having determined termination values for all outstanding Transactions, representing respective losses and gains of the Non-defaulting Party flowing from the early termination under Section 6, and any Unpaid Amounts, those termination values and Unpaid Amounts would be automatically and mandatorily set off under Rule ~~4.90~~14.25 of the Insolvency

[~~55~~66] Section 6(c)(ii) operates upon the occurrence (in the case of Automatic Early Termination) or effective designation (in the case of notice under Section 6(a)) of an Early Termination Date. An Early Termination Date is effectively designated when a notice designating the Early Termination becomes effective in accordance with Section 12. This will occur before the Early Termination Date itself, except where the Non-defaulting Party designates the effective date of the notice as the Early Termination Date.

(England and Wales) Rules ~~1986~~2016. The date of the set-off would be the date of the winding up order. As already noted, it is not possible to contract out of this set-off.[~~56~~67]

Insolvency set-off is available even though the claims are not liquidated or are not connected with each other. It is not necessary that the claims arise out of similar transactions. There is therefore no objection to "cross-product netting" under English law.

You asked us to assume that after a winding up has commenced in respect of the English Company, the liquidator seeks to assume the profitable Transactions and to reject or disclaim the unprofitable Transactions. This power of disclaimer, which is provided for in section 178 of the Insolvency Act 1986, is often referred to in commercial parlance as "cherry-picking". Protection from disclaimer or cherry-picking (although not strictly needed) is given by the fact that the ISDA Master Agreement (including all Transactions) constitutes a single agreement and that therefore contractually on default only a single net claim is due under Section 6(e).

It is a general principle of disclaimer under English law that a liquidator may not disclaim only part of a contract. Disclaimer is all or nothing.[~~57~~68] The policy is that the liquidator should not take the benefit of a contract without the burden. In any case, the liquidator does not have the power to prevent exercise of contractual early termination rights under Sections 6(a) and 6(c)(ii) of the ISDA Master Agreement or, if we rely on insolvency set-off analysis, insolvency set-off in relation to termination values determined under Section 6(e) of the ISDA Master Agreement. Therefore, an English liquidator will not be able to disclaim or cherry-pick Transactions entered into before the commencement of the relevant winding up.

Any disposition of an insolvent party's property, for example, a payment under a Transaction, made after the commencement of the winding up (i.e. the winding up petition) 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.

If we analyse the close-out netting provisions of Section 6(e) on a flawed asset basis, the insolvent party's property will never be anything more than a conditional claim which is worthless if the relevant condition has failed. There is, therefore, no disposition of the insolvent party's property. If we apply the set-off analysis, the application of insolvency set-off is not considered a disposition for this purpose.

In addition, under the FCA Regulations,[~~58~~69] section 127 does not apply to any ISDA Master Agreement that would constitute a financial collateral arrangement or is part of an arrangement of which a financial collateral arrangement forms part for purposes of the FCA Regulations to the extent that section 127 would prevent the close-out netting provision of the ISDA Master Agreement from taking effect in accordance with its terms. The FCA Regulations[~~59~~70] also provide that section 178 of the Insolvency Act 1986 shall not apply to a financial collateral arrangement where the collateral-provider or collateral-taker is subject to winding-up proceedings.

~~56~~67 *Halesowen Presswork* (note ~~44~~54).

~~57~~68 Consider *Re Bastable* [1901] 2 KB 518; *Re The Nottingham General Cemetery Co* [1955] Ch 683.

~~58~~69 Regulation 10(1).

~~59~~70 Regulation 10(4).

Mutuality required for insolvency set-off

We made assumption (~~h~~i)(i) above because insolvency set-off under English law requires strict mutuality in the sense that each party is personally liable for its obligations under the ISDA Master Agreement and each Transaction and is solely beneficially entitled to any rights it has under the ISDA Master Agreement and each Transaction.~~[60]~~[71]

We consider the case of Multibranch Parties in part IV, however, we briefly note here in relation to mutuality that the fact that two claims to be set off are owed respectively by one branch of the insolvent party and to another branch of the insolvent party does not affect the question of mutuality for this purpose since both branches are part of the same legal entity.

Cut-off rules for set-off in winding up and in administration

We made assumption (~~h~~i)(ii) above because if a Transaction is entered into after the occurrence of any of the events referred to in assumption (~~h~~i)(ii), a termination value relating to that Transaction will not be eligible for insolvency set-off under Rule ~~4.90.~~~~[61]~~ 14.25.[72] These are sometimes referred to as "cut-off rules", as the eligibility of a claim for inclusion in the automatic set-off under Rule ~~4.90~~14.25 is cut off by the interposition of any of the events set out in that assumption. The purpose of a cut-off rule is to avoid, after the defined cut-off point, a build-up of set-offs against the insolvent debtor, which would otherwise diminish the insolvent estate to the detriment of unsecured creditors generally.

Under paragraph ~~3~~2 of Rule ~~4.90~~14.25 of the Insolvency (England and Wales) Rules ~~1986~~2016, the winding up insolvency set-off provision, "[a]n account ~~shall~~must be taken of what is due from the company and the creditor to each ~~party to the~~ other in respect of ~~the~~their mutual dealings ~~[between the parties],~~ and the sums due from the one ~~party shall~~must be set off against the sums due from the other."

Paragraph ~~2~~6 of Rule ~~4.90~~14.25 provides that "mutual ~~credits, mutual debts or other mutual~~ dealings" do not include any debts arising out of an obligation incurred after any of the events specified in assumption (~~h~~i)(ii).

~~60~~71 Rule ~~4.90~~14.25 of the Insolvency (England and Wales) Rules ~~1986~~2016.

~~61~~ ~~That assumption combines the Rule 4.90 cut-off rules with the cut-off rules for the comparable set-off provision in Rule 2.85 of the Insolvency Rules 1986, which applies in an administration where the administrator has given notice of an intention to make a distribution to creditors. Rule 2.85 is discussed in part III.3(3)(b) below.~~

72 That assumption combines the Rule 14.25 cut-off rules with the cut-off rules for the comparable set-off provision in Rule 14.24 of the Insolvency (England and Wales) Rules 2016, which applies in an administration where the administrator intends to make a distribution and has delivered a notice under Rule 14.29. Rule 14.24 is discussed in part III.3(3)(b) below.

Avoidance of transactions at an undervalue, preferences and transactions defrauding creditors

We made assumption (~~h~~i)(iii) above because:

(i) any transaction falling within the description in assumption (~~h~~i)(iii)(B) by an English Company with any person within the relevant suspect period before the commencement of the winding up of the English Company may be set aside as a transaction at an undervalue under section 238 of the Insolvency Act 1986; and

(ii) any action of a type falling within the description in assumption (~~h~~i)(iii)(C) taken by an English Company in favour of any person during the relevant suspect period before the commencement of the winding up of the English Company may be set aside as a preference under section 239 of the Insolvency Act 1986.

In the case of (i) above, the relevant suspect period is two years ending with the onset of insolvency; and in the case of (ii) above, the relevant suspect period is six months ending with the onset of insolvency for a transaction with or action in favour of an unconnected person and two years for a connected person, provided in either case that at the time of the relevant transaction or action, the English Company was insolvent under the criteria applicable under the Insolvency Act 1986 or became so as a result of the suspect transaction or action. This proviso is the reason for our assumption (~~h~~i)(iii)(A). The suspect period will also run, to the extent not already captured by the period above, (i) between the making of an administration application and the making of an order in respect of such application; and (ii) between the filing of a notice to appoint an administrator under paragraphs 14 or 22 of Schedule B1 of the Insolvency Act 1986 and the appointment of an administrator. Note that there is no express provision protecting a creditor who did not know of the actual insolvency of the English Company or, if applicable, of its preferential motive.

Assumption (~~h~~i)(iii) ~~above~~ also addresses section 423 of the Insolvency Act 1986, dealing with transactions defrauding creditors, which is similar to section 238, the key differences for present purposes being that there is no time limit on when the relevant transaction was entered into prior to insolvency of the English Company and there is no requirement that the English Company giving the undervalue be insolvent at the time of, or as a result of, the transaction.

We think it unlikely that a new transaction entered into at arm's-length will have an element of gift or undervalue from the insolvent party to the solvent party or will be capable of being set aside as a preference.

(b) Administration

The other important form of corporate insolvency proceeding to which an English Company could be made subject is administration. Administration is a form of rehabilitation or reorganisation proceeding. Until 2003, administration was not an end in itself, but an interim step, ending with the company re-emerging as a going concern or in a voluntary arrangement or insolvent winding up. However, since the Enterprise Act 2002, the administrator has had the power to make distributions to creditors within the administration provided that he gets the leave of the court to do so.

Although a voluntary arrangement or an insolvent winding up were, prior to the Enterprise Act 2002, the more common outcomes of administration, the Enterprise Act 2002 placed the primary emphasis on rescuing the company as a going concern in all cases.

An administrator has a number of powers under the Insolvency Act 1986 and the Enterprise Act 2002 while in office. The administrator does not, however, have the power to prevent the exercise of contractual termination rights or the exercise of a contractual right to net or set off mutual losses and gains. While the Insolvency Act 1986 provides in paragraphs 43(2), 43(6) and paragraph 44 of Schedule B1 that when an administrator is appointed, or in some cases of an earlier stage in the procedure, "no step may be taken to enforce security over the company's property" and "no legal process (including legal proceedings, execution, distress and diligence) may be instituted or continued against the company", the exercise of contractual early termination, valuation and netting or set-off rights, such as those provided for in Section 6 of the ISDA Master Agreement are not, in our view, stayed by paragraphs 43 and 44. The close-out netting provisions are not a "proceeding", "execution" or "legal process" in the sense intended in paragraphs 43 and 44, but rather a contractual self-help remedy not involving court or arbitral process.[~~62~~73]

Rule ~~2.85~~14.24 of the Insolvency (England and Wales) Rules ~~1986~~2016 provides for set-off in administration in circumstances where ~~an~~the administrator ~~gives notice that he proposes~~intends to make a distribution ~~to creditors. Rule 2.85~~and has delivered a notice under Rule 14.29. Rule 14.24 largely mirrors the wording of Rule ~~4.90~~14.25. In view of our principal conclusion that ~~close out~~close-out netting under the ISDA Master Agreement does not involve (except to the limited extent described in part III.3(3)(a) above) contractual ~~set off~~set-off, the fact that a mandatory insolvency ~~set off~~set-off rule, Rule ~~2.85~~14.24, comparable to Rule ~~4.90~~14.25 also applies in administration in certain circumstances does not affect our analysis leading to that conclusion.

If, however, we were to analyse the close-out netting provisions of the ISDA Master Agreement on the basis of administration set-off, given that Rule ~~2.85~~14.24 largely mirrors Rule ~~4.90~~14.25 (with some differences that are not relevant for present purposes), similar reasoning to that set out above in relation to winding up proceedings would apply, including the application of certain cut off rules to prevent a ~~build up of set off~~build-up of set-off rights, which are summarised for both winding up and administration in assumption (~~h~~i)(ii). See also (a) above in respect of winding up or liquidation in respect of the cut-off rules and the provisions of the Insolvency Act 1986 relating to the avoidance of transactions.

(c) Company voluntary arrangement

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. Subject to the discussion below, the Non-defaulting Party should have time to exercise its rights under the close-out netting provisions before the CVA is approved by creditors ~~in a properly convened creditors' meeting~~pursuant to a qualifying decision procedure of which the Non-defaulting Party has notice. Note that every creditor ~~that~~

~~62~~73 See *Re Paramount Airways Ltd* [1990] BCC 130; *Re Olympia & York Canary Wharf Ltd* [1993] B.C.C. 154. We also note that these provisions do not apply in respect of security interests created or otherwise arising under a financial collateral arrangement, as defined in and provided for in the FCA Regulations.

~~a~~of the company, whose claim and address the person seeking the decision is aware of, should be ~~summoned to the meeting~~given notice of the qualifying decision procedure but a CVA binds all unsecured creditors including creditors who did not receive notice ~~of the meeting~~.

In practice, the Non-defaulting Party will almost certainly have exercised its rights under the close-out netting provisions at or shortly after the time it received notice of the relevant ~~meeting~~qualifying decision procedure, at least where the Non-defaulting Party has a credit monitoring process in place. The possibility of a CVA is not, therefore, a serious practical concern.

The Insolvency Act 2000 (Commencement No. 3 and Transitional Provisions) Order 2002 brought into force provisions of the Insolvency Act 2000 relating to CVAs. Under these provisions, directors of an eligible company are permitted, in connection with a proposal for a CVA, to obtain a moratorium on the enforcement of claims against the company. An eligible company is a "small company", that is, a company not exceeding various statutory size criteria. There are also a number of exclusions from eligibility.[~~63~~74]

Even where the company concerned is eligible and exclusions do not apply, any moratorium would not, in our view, affect the operation of the close-out netting provisions of the ISDA Master Agreement, although it could affect the manner and timing of enforcement of a resulting net claim against an eligible company.

It is possible that the net claim (to the extent that it is not secured) could be reduced under the terms of the CVA.

(d) Scheme of arrangement

As in the case of a CVA under the Insolvency Act 1986, a creditor of an English Company in financial difficulties would normally have notice of a meeting of creditors called to consider a scheme of arrangement under Part 26 of the Companies Act 2006.

As no moratorium applies in relation to this type of proceeding, the Non-defaulting Party would have time to exercise its rights under the close-out netting provisions of the ISDA Master Agreement before the scheme of arrangement was approved, and therefore as a practical matter the possibility of a scheme of arrangement should not be of concern in relation to the enforcement of those provisions.[~~64~~75]

(e) Administrative receivership

A holder of a floating charge over all or substantially all of the assets of an English Company may, subject to certain conditions, appoint a type of receiver known as an "administrative receiver" to conduct what is referred to as an "administrative receivership".

Historically, an administrative receivership was not an insolvency proceeding (and it is still not considered an insolvency proceeding for purposes, for example, of the EC

~~63~~74 The eligibility criteria and qualifying conditions for a company applying for a moratorium are set out in paragraphs 2, 3 and 4 of Schedule A1 to the Insolvency Act 1986.

~~64~~75 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.

Insolvency Regulation~~[65]~~[76]), because the administrative receiver was appointed to act for the holder or holders of the relevant floating charge in order to realise the security constituted by that floating charge. Because the administrative receiver in effect took over management of the whole business of the chargor, the Insolvency Act 1986 imposed duties on the administrative receiver to consider the interests of the employees and general creditors of the chargor in various respects. Thus administrative receivership was *de facto* an insolvency proceeding and treated as such by insolvency practitioners and the legal profession.~~[66]~~[77]

Administrative receivership has for the most part been abolished by the Enterprise Act 2002, although it remains relevant for universal floating charges made before 15 September 2003 and certain categories of charge exempted from the provisions of the Enterprise Act 2002.~~[67]~~[78] Even where an administrative receivership might still apply, there is, in our view, no provision of English insolvency law or any other law that gives an administrative receiver any power to prevent or avoid the effect of the close-out netting provisions of the ISDA Master Agreement. 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) in respect of which see (a) above.~~[68]~~[79]

(4) *Assuming the parties have entered into either a 1992 Agreement or a 2002 Agreement, one of the parties is insolvent and the parties have selected a Termination Currency other than the currency of the jurisdiction in which the insolvent party is organised, is it possible to "prove" (that is, file) a claim in a local insolvency proceeding in a foreign currency?*

~~For the purposes of proving in the liquidation~~In respect of the winding up or administration of an English Company, a ~~creditor's claim must be expressed in Sterling. Rule 4.91 of the Insolvency Rules 1986 provides that for the purposes of proving a debt~~proof for a debt incurred or payable in a foreign currency ~~other than Sterling~~must state the amount of the debt ~~is to be converted into Sterling at the official exchange rate~~in that currency and, pursuant to Rule 14.21(2) of the Insolvency (England and Wales) Rules 2016, the office-holder must convert all such debts into sterling at a single rate for each currency determined by the office-holder by reference to the exchange rates prevailing on the "relevant date~~ when the company went into liquidation or, if the liquidation~~". The "relevant date" is defined at Rule 14.1 and means:

(a) in the case of an administration:

(i) if the administration was not immediately preceded by a winding up, the date on which the company entered administration; or

(ii) if the administration was immediately preceded by a winding up, the date on which the company went into liquidation; and

(b) in the case of a winding up:

~~65~~76 See note ~~38~~48.

~~66~~77 RM Goode, *Principles of Corporate Insolvency* (4th edn Sweet & Maxwell, London 2011) para 10-06 and 10-48.

~~67~~78 See for example, sections 72B to 72GA of the Insolvency Act 1986.

~~68~~79 See section 424(c) and Schedule 1, para 5 of the Insolvency Act 1986.

(i) if the winding up was not immediately preceded by an administration, the date on which the company went into liquidation; or

(ii) if the winding up was immediately preceded by an administration, ~~on~~ the date ~~that~~on which the company entered administration.

If a creditor considers that the rate determined by the office-holder is unreasonable they may apply to the court. If the court finds that the rate is unreasonable it may itself determine the exchange rate.[80]

~~The "official exchange rate" is defined as the "middle exchange rate on the London Foreign Exchange Market at the close of business, as published for the date in question. In the absence of any such published rate, it is 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.~~~~[69]~~

~~In practice, it is likely that a court would accept a reasonably determined mid-market foreign exchange rate for the relevant date.~~~~[70]~~

~~For the purposes of proving in the administration of an English Company, in a case where the administrator has given notice of an intention to make a distribution to creditors, Rule 2.86 of the Insolvency Rules 1986 applies substantially the same rule as that set out in Rule 4.91.~~

~~Rule 4.90(6) provides~~Rules 14.25(8) and 14.24(8) provide that Rule ~~4.91~~14.21 also applies for the purpose of determining the exchange rate applicable to sums payable in a foreign currency to the insolvent party which are to be set-off under ~~Rule 4.90~~Rules 14.25 and 14.24 (respectively) against sums owed by the insolvent party.

In our view, ~~Rules 2.86 and 4.91~~Rule 14.21 would, where relevant, apply to the net claim of the solvent Non-defaulting Party as determined under Section 6(e). In other words, an English court would not require that the mark-to-market value of each Terminated Transaction determined for purposes of Section 6(e) be converted separately in accordance with the relevant Rule before being set off under the corresponding insolvency set-off provision (Rule ~~2.85~~14.24, in the case of administration, or Rule ~~4.90~~14.25, in the case of liquidation). This follows from our view, set out in (3) above, that an English court would recognise and give effect to the net amount determined under Section 6(e) and would not view that provision as a form of contractual set-off provision to be displaced by Rule ~~2.85~~14.24 or Rule ~~4.90~~14.25, as the case may be.~~[71]~~[81]

If, however, we are wrong, then the close-out value of each Terminated Transaction determined under Section 6(e) and each Unpaid Amount (in each case, where the relevant value or amount is denominated in a currency other than ~~Sterling~~sterling) would be compulsorily converted to ~~Sterling at~~sterling at the prevailing rate on the relevant date, rather than in accordance with the terms of Section 6(e) as to the timing and conversion of all values into the Termination Currency, in accordance with the definition in Section 14 of "Termination Currency Equivalent".

80 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 of the Insolvency Rules 1986, which was the predecessor to Rule 14.21 of the Insolvency (England and Wales) Rules 2016 in respect of administration.

~~69~~ ~~For example, how does one determine what constitutes the "published rate" for any particular date?~~

~~70~~ ~~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, which, as noted in the text below, is the equivalent rule for administration to Rule 4.91.~~

~~71~~81 Although note the limited contractual set-off that applies in respect of Unpaid Amounts (as discussed above).

The ultimate claim by or against the Non-defaulting Party would be a net claim, but its quantum would not necessarily match the quantum that would be determined in accordance with Section 6(e). It does not follow that this net claim would necessarily be less favourable to the Non-defaulting Party. The Non-defaulting Party's net claim would, however, be more likely to diverge from its true economic position, as determined by its losses and gains associated with unwinding or re-establishing hedge or related trading positions following default by the other party.

If the ISDA Master Agreement forms part of a financial collateral arrangement under the FCA Regulations, 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, Regulation 14 states that neither Rule 4.91 nor Rule 2.86 ~~applies~~of the Insolvency Rules 1986 apply 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~~ into sterling or provides for the debt owed by the party in liquidation or administration to be assessed in a currency other than sterling, unless "the arrangement provides for an unreasonable exchange rate or the collateral-taker uses the mechanism provided under the arrangement to impose an unreasonable exchange rate". In 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 such that the currency conversions contemplated Section 6(e) are not displaced by Rule 4.91 (or Rule 2.86). ~~[72]~~ As outlined above, Rules 14.24 and 14.25 of the Insolvency (England and Wales) Rules 2016 are (with effect from 6 April 2017) the insolvency set-off rules applicable to English Companies in an administration or winding up (respectively) and have superseded Rules 2.85 and 4.90 of the Insolvency Rules 1986 and Rule 14.21 of the Insolvency (England and Wales) Rules 2016 has, in turn, replaced Rules 2.86 and 4.91 of the Insolvency Rules 1986. The FCA Regulations have not been updated to reflect this change but, in our view, Regulation 14 should be read as applying to Rule 14.21.[82] However, where the Termination Currency is a currency other than ~~Sterling~~sterling, Rule ~~4.91 (or Rule 2.86)~~14.21 would still apply in order to convert it into ~~Sterling~~sterling for the purpose of proving the debt. The FCA Regulations will be relevant where an ISDA Master Agreement has been entered into in connection with an ISDA Credit Support Document that constitutes a financial collateral arrangement falling within the FCA Regulations.

(5) *Outside the context of insolvency proceedings, assuming the parties have selected a Termination Currency other than Sterling, would an English court enforce a claim for the net termination amount in the Termination Currency?*

Outside of the context of insolvency proceedings, the English court can award judgment for a sum of money expressed in a foreign currency.~~[73]~~[83] This power may be exercised whether the

~~72~~ ~~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) 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.~~

82 In any event, 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) and would not view that provision as a form of contractual set off provision to be displaced by Rule 14.24 or Rule 14.25, as the case may be, in any event, other than potentially in respect of Unpaid Amounts.

~~73~~83 *Miliangos* v *George Frank (Textiles) Ltd* [1976] AC 443, HL.

applicable law of the contract is foreign law[~~74~~84] (that is, in the context of this memorandum, New York law) or English law.[~~75~~85] It is not restricted to claims for payment of debts[~~76~~86] but extends to claims for damages for breach of contract whether the claim is for liquidated[~~77~~87] or unliquidated damages.[~~78~~88]

The judgment will be for payment of the amount of the foreign currency or the ~~Sterling~~sterling equivalent at the time of payment.[~~79~~89] The "time of payment" means that if the defendant fails to deliver the foreign currency the date for its conversion into ~~Sterling~~sterling should be "as close as practicable to the date of payment, having regard to the realities of enforcement procedures"[~~80~~90]. This reflects the fact that "if the judgment is one expressed in a foreign currency, it *must* be converted into Sterling so that those responsible for enforcing the judgment (whether by levying execution or otherwise) may know what steps are open to them and how far they can go".[~~81~~91] In other words, it is generally not possible to execute a judgment expressed in a foreign currency.[~~82~~92] It must first be converted into ~~Sterling~~sterling to allow those executing the judgment to know whether they have satisfied the judgment or not.

As to Section 8(b) of the ISDA Master Agreements, we refer to qualification (2) in part V of this memorandum below.

~~74~~84 *Miliangos* v *George Frank (Textiles) Ltd* [1976] AC 443, HL.

~~75~~85 *Federal Commerce and Navigation Co Ltd* v *Tradax Export SA, The Maratha Envoy* [1977] 1 QB 324 (CA) (reversed subsequently but on grounds not bearing on this point [1978] AC 1).

~~76~~86 *Miliangos* v *George Frank (Textiles) Ltd* [1976] AC 443, HL.

~~77~~87 *Federal Commerce and Navigation Co Ltd* v *Tradax Export SA* [1977] 1 QB 324, CA.

~~78~~88 *Services Europe Atlantique Sud (SEAS)* v *Stockholms Rederiaktiebolag af Stockholm SVEA*, *The Folias* [1979] AC 685, HL.

~~79~~89 See paragraph 10 of Practice Direction 40B, supplementing Part 40 of the Civil Procedure Rules.

~~80~~90 *Carnegie v Giessen and others* [2005] 1 WLR 2510.

~~81~~91 *Miliangos* v *George Frank (Textiles) Ltd* [1976] AC 443, 498 per Lord Edmund-Davies, HL.

~~82~~92 In *Carnegie* (see note ~~80~~90) it was held that a Charging Order could be expressed in a foreign currency.

IV. CLOSE-OUT NETTING FOR MULTIBRANCH PARTIES

1. Conclusions

(1) Our conclusions in Annex 1 to this memorandum would not be affected by the fact that the English Bank is acting as a Multibranch Party in jurisdictions where close-out netting is enforceable.

(2) Whether an English branch of a foreign bank could be wound up in England depends on whether the foreign bank is an EEA credit institution or not. If the foreign bank is an EEA credit institution, the Winding Up Regulations will apply (as discussed below) and the foreign bank is not liable to be wound up or subject to resolution action in England.

(3) In respect of a foreign bank that is not an EEA credit institution, in the event of the winding up (liquidation) in England of the English branch of a foreign bank, an English liquidator would not be able to take any action that would affect the close-out netting of Transactions under an ISDA Master Agreement by, for example, attempting to claim amounts purportedly due to the English branch of the foreign bank free of an insolvency set-off (or equivalent netting protection) available in the home country of the foreign bank.

(4) If a foreign bank that is not an EEA credit institution is subject to a recognised Third Country Resolution Action~~,~~ resolution action may also be taken in England and the Third Country Resolution Action will have effect in ~~each case as~~England. Resolution action may also be taken in England in respect of the UK branch of such a Third Country Institution independently of Third Country Resolution Action in certain circumstances. Resolution action is discussed in more detail below.

(5) Certain risks may arise, including enforcement of foreign judgments, if Transactions are entered into by a branch of an English Bank in a Non-Netting Jurisdiction (as defined below) or by an English branch of a foreign bank incorporated in a Non-Netting Jurisdiction.

2. Assumptions

For purposes of our analysis of the multibranch netting provisions of the ISDA Master Agreement in this part IV, we make the assumptions in part III.2 and the following additional assumptions:

(a) An English Bank has entered into an ISDA Master Agreement on a multibranch basis. In the ISDA Master Agreement the English Bank was specified as a "Multibranch Party" and the parties have also specified that Section 10(a) applies to the English Bank. The English Bank has entered into Transactions under an ISDA Master Agreement through an office in England and also through one or more branches located in other countries that had been specified in the Schedule. After entering into these Transactions and prior to their maturity, the English Bank becomes the subject of insolvency proceedings in England.

(b) A Bank/Credit Institution (**Bank F**), organised and with its headquarters in a jurisdiction (**Country H**) other than England, has entered into an ISDA Master Agreement on a multibranch basis. In the ISDA Master Agreement Bank F was specified as a "Multibranch Party" and the parties have specified that Section 10(a) applies to Bank F. Bank F has entered into Transactions under an ISDA Master Agreement through its head office in Country H and also through one or more branches located in other countries that had been specified in the Schedule, including its branch located in and subject to the laws of England (the **English Branch**). After entering into these Transactions and prior to their maturity, Bank F becomes the subject of a voluntary or involuntary ~~proceedings~~proceeding under the insolvency laws of Country H. You have asked us to assume that close-out netting under the ISDA Master Agreement would be enforced in accordance with its terms in that proceeding against Bank F.

3. Questions relating to Close-out Netting for Multibranch Parties

(1) *In relation to a multibranch party organised in your jurisdiction would there be any change in your conclusions concerning the enforceability of close-out netting under the ISDA Master Agreement based upon the fact that the bank has entered into an ISDA Master Agreement on a multibranch basis and then conducted business in that fashion prior to its insolvency?*

Subject to the discussion in part IV.3(3) below, there would be no change in our conclusions in Annex 1 to this memorandum concerning the enforceability of close-out netting under the ISDA Master Agreement against an English Bank based upon the facts set out in assumption (a) above.

This conclusion is subject to the following qualifications:

(a) It is not necessary to consider the impact of the EC Insolvency Regulation[~~83~~93] on the facts set out in assumption (a) above, as the EC Insolvency Regulation does not apply to an English Bank. It is, however, necessary to consider the impact of the Credit Institutions (Reorganisation and Winding Up) Regulations 2004[~~84~~94] (the **Winding Up Regulations**), implementing Directive 2001/24/EC on the reorganisation and winding up of credit institutions (the **Winding Up Directive**).[95]

In relation to the issues discussed in this memorandum, the principal effects, as far as an English Bank is concerned, are that:

(i) an English court will not recognise winding up proceedings or reorganisation measures (including the application of the resolution tools and the exercise of the resolution powers provided for in the BRRD (as defined in Annex 1)), as those terms are defined in the Winding Up Directive,[~~85~~96] opened in relation to the English Bank in any other member state of the European Economic Area (the **EEA**)[~~86~~97];

[~~83~~93] See note ~~38~~48.

[~~84~~94] SI 2004/1045.

[95] Please note that the various references to the Insolvency Rules 1986 in the Winding Up Regulations have not been updated to reflect the introduction of the Insolvency (England and Wales) Rules 2016. See discussion of the Dear IP Letter at part I.5 above.

[~~85~~96] It is not necessary for present purposes to say which types of English insolvency proceedings that may be applied in relation to an English Bank, as discussed in Annex 1, are "winding up proceedings" and which types are "reorganisation measures" for the purposes of the Winding Up Directive.

[~~86~~97] The member states of the EEA are 28 member states of the European Union, Iceland, Liechtenstein and Norway. The EEA Enlargement Agreement under which Croatia joined the EEA is provisionally applicable pending ratification by the parties to the agreement.

(ii) English law will govern any winding up proceedings or reorganisation measures commenced in England in relation to the English Bank, subject to certain choice of law exceptions in Articles 20 to 27 and 30 to 32 of the Winding Up Directive, the principal such exceptions relevant to the present discussion being those in Article 23(1) and Article 25, which are discussed in Appendix D. Articles 23 and 25 are reflected in regulations 28 and 34 of the Winding Up Regulations; and

(iii) The Winding Up Directive, if implemented in the relevant EEA ~~Member State~~member state, provides for winding up and reorganisation measures to be effective across the EEA. As noted in Annex 1, the Banking Act also provides for an English Bank to be subject to the SRR (as defined in Annex 1). The Winding Up Directive was amended by the BRRD such that reorganisation measures includes the application of the resolution tools and the exercise of resolution powers provided for in the BRRD. Therefore, within the EU, if the BRRD has been properly implemented, the application of the resolution tools and the exercise of resolution powers provided for in the BRRD should also be effective across the EU. However, note that the BRRD has not yet been adopted by the EEA.

(b) The English courts, in conducting the winding up[~~87~~98] of the English Bank, will do so in principle, subject to certain qualifications and practical limitations, on a "universal" basis. In other words, the English liquidator will seek to collect, as far as practicable, all assets of the English Bank worldwide[~~88~~99] and will permit any creditor of the English Bank, without discrimination between local and foreign creditors, to prove for any claim it has against the English Bank in the English winding up, subject to the "hotchpot rule".

(c) The "hotchpot rule" provides that a creditor that has received a distribution in any insolvency proceedings relating to a debtor outside of England may not receive any distribution (referred to in English winding up proceedings as a "dividend") in the English proceedings until the other creditors claiming in the English proceeding have received a distribution equal in proportion to their respective claims to that which that creditor has already obtained abroad. Alternatively, any creditor claiming in the English proceedings may be required to disgorge any assets recovered abroad before being permitted to file its claim in the English proceedings.

(d) Under English law, the English Bank, including all of its branches in foreign jurisdictions, would be considered a single legal entity. Therefore, all of its assets (subject to collection) and liabilities, whether or not acquired or incurred

~~87~~98 Paragraphs (b) to (f) of this section refer to a liquidation or winding up of an English Bank with branches overseas. We note that other forms of insolvency proceedings can be commenced in relation to English Banks as set out in Annex 1. Outside the context of the Winding Up Directive (referred to above), there is very little case law on the cross-border aspects of insolvency proceedings other than liquidation or winding up proceedings. However, where those other proceedings involve the collection of assets and distributions to creditors, we see no reason why the principles described in paragraphs (b) to (f) should not apply equally to those other proceedings.

~~88~~99 The Winding Up Directive, if implemented in a particular member state of the EEA, will require that member state to recognise the English proceedings, thus assisting the English liquidator in collecting the assets.

in England, will be subject, as far as English law is concerned, to the winding up in England. Of course, this does not mean that foreign law will not be relevant to the determination of the nature and/or other aspects of an asset located or liability owed outside England.

(e) There will, of course, be practical limitations, as well as limitations arising under principles of private international law, on the ability of the English liquidator to recover assets located outside England although within the EEA, the liquidator will be greatly assisted by the Winding Up Directive.

(f) Liabilities owed by the English Bank outside England will be included within the scope of, and therefore subject to, the English winding up.

(g) As discussed in part III.3(3) above, we believe that close-out netting would be enforceable whether considered on a flawed asset or on an insolvency set-off basis. In the latter case, to achieve this, it is necessary, in the case of Transactions that would be characterised as executory contracts, to be able to terminate the Transactions on insolvent winding-up[~~89~~100] in England and then to be able to set off the resulting termination values. As discussed above, we do not believe that any provision of English insolvency law would prevent the termination of such Transactions in the event of English winding up proceedings in relation to the English Bank. This conclusion would not be affected by the fact that some (or all) of the Transactions are booked in branches of the English Bank outside England.

As regards close-out netting, amounts due under Section 6(e) of the ISDA Master Agreement would be due by or to the English Bank without reference to any branch location and, for the reason given above, would fall within the scope of the insolvency set-off provision in Rule ~~4.90~~14.25 or Rule ~~2.85~~14.24.

(h) Even if, contrary to Sections 6(c)(ii) and Section 6(e), an English court were to take the view that termination values in respect of individual Terminated Transactions were owed by or to (as the case may be) the branch where the individual Transaction is booked, then, for the reason given above, such termination values would fall within the scope of the insolvency set-off provision. This view is supported by the decision in *Re Hett, Maylor & Co Ltd*.[~~90~~101] In this case a company in liquidation in England owed a debt to its bank (apparently in England although this is not clear from the report), and the bank owed the company a credit balance at its Manila branch. It was held that there was a set-off.

(2) *In relation to a multibranch party with a branch located in your jurisdiction:*

(a) *would there be a separate proceeding in your jurisdiction with respect to the assets and liabilities of the Local Branch at the start of the insolvency proceeding for Bank F in Country H? Or would the relevant authorities in your jurisdiction defer to the proceedings in Country H so that the assets and liabilities of the Local Branch would be handled as part of the*

~~89~~100 Paragraphs (g) and (h) of this section refer to a liquidation or winding up of the English Bank. We note that other forms of insolvency proceedings can be commenced in relation to an English Bank as set out in Annex 1. The differences in principle between these proceedings are highlighted in Annex 1 but these would not affect our conclusions in paragraphs (g) and (h).

~~90~~101 (1894) 10 TLR 412.

proceedings for Bank F in Country H? Could local creditors of the Local Branch initiate a separate proceeding in your jurisdiction even if the relevant authorities in your jurisdiction did not do so?

(b) *if there would be a separate proceeding in your jurisdiction with respect to the assets and liabilities of the Local Branch, would the relevant insolvency official and the courts in your jurisdiction, on the facts above, include Bank F's position under an ISDA Master Agreement, in whole or in part, among the assets of the Local Branch and, if so, would the insolvency official and the courts in your jurisdiction recognise the close-out netting provisions of the ISDA Master Agreement in accordance with their terms? The most significant concern would arise if the insolvency official or court considering a single ISDA Master Agreement would require a counterparty of the Local Branch to pay the mark-to-market value of Transactions entered into with the Local Branch to the insolvency official of the Local Branch while at the same time forcing the counterparty to claim in the proceedings in Country H for its net value from other Transactions with Bank F under the same ISDA Master Agreement. In considering this issue, please assume that close-out netting under the ISDA Master Agreement would be enforced in accordance with its terms in the proceedings for Bank F in Country H.*

The answers to the foregoing questions depend on whether or not Bank F is an EEA credit institution.[~~91~~102] "EEA credit institution" is defined in the Winding Up Regulations to mean an EEA undertaking, other than a UK credit institution, of the kind mentioned in Article 4(1)(1) and 4(1)(17) of the Capital Requirements Regulation[~~92~~103] and subject to the exclusion of the undertakings referred to in Article 2(5)(2) to (23) of the Capital Requirements Directive.[~~93~~104] This means, in essence, a credit institution that is headquartered and principally supervised in a member state of the EEA other than the United Kingdom.

(A) Where Bank F is an EEA credit institution:

If Bank F is an EEA credit institution, the following applies:

(i) Under the Winding Up Regulations, no winding up or administration proceedings or reorganisation measures in respect of Bank F or its English Branch can be undertaken in the United Kingdom except in the circumstances permitted by the Winding Up Regulations. Note that in particular, regulation 3(7A), provides that a 'stabilisation instrument' cannot not be made by the Authorities in respect of an EEA credit institution.

(ii) The Winding Up Regulations further provide that the effects of any winding up or reorganisation proceedings commenced in an EEA member state are to be effective throughout the EEA without any further formalities. Accordingly,

~~91~~102 Note that in this ~~Part~~part IV we assume Bank F is located outside of the United Kingdom as a whole rather than just outside of England. Different recognition regimes apply in respect of the constituent parts of the UK – for example section 426(1) of the Insolvency Act 1986 provides that an order made in a court in any part of the UK in the exercise of jurisdiction in relation to insolvency law shall be enforced in any other part of the UK as if it were made by a court exercising the corresponding jurisdiction in that part of the UK.

~~92~~103 Regulation (EU) No. 575/2013.

~~93~~104 Directive 2013/36/EU.

any reorganisation or winding up proceedings commenced elsewhere in the EEA are to be recognised in the United Kingdom.

(iii) Under the Winding Up Regulations a reorganisation measure includes (i) any reorganisation measures under Article 2 of the Winding Up Directive (which as discussed above includes the application of the resolution tools and the exercise of resolution powers provided for in the BRRD) and (ii) any measure to be given effect in or under the law of the United Kingdom pursuant to Article 66 (Power to enforce crisis management measures or crisis prevention measures by other Member States) of the BRRD. In relation to the extent of the mutual recognition regime see ~~*Goldman Sachs International*~~*New Zealand Superannuation Fund* *v Novo Banco* ~~*SA*~~.~~[94]~~[105] As noted above, the BRRD has not yet been incorporated into the EEA Agreement.

(iv) In respect of insolvency, the basic rule of the Winding Up Directive, subject to certain important exceptions, two of which are discussed below, 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. The Winding Up Directive, in contrast to the EC Insolvency Regulation, which applies to corporate insolvencies (outside the scope of the Winding Up Directive or the Insurance Winding Up Directive), does not permit host member states (in other words, member states where the credit institution has a branch) to open local insolvency proceedings (secondary or otherwise) in relation to the insolvent credit institution.

(v) The Winding Up Directive includes a number of derogations from the basic rule that the law of the home member state of a European credit institution governs the effect of insolvency proceedings in relation to that credit institution. These are set out in Articles 20-27 and 30-33 of the Winding Up Directive. For purposes of this memorandum, the most relevant derogations are set out in Articles 23(1) and 25 of the Winding Up Directive. These are discussed in Appendix D.

(vi) Regulation 4 of the Winding Up Regulations provides that notwithstanding the prohibition on winding up, an EEA credit institution is to be treated as a company liable to be wound up under the Insolvency Act 1986 if it would be liable to be wound up under that Act but for the prohibition in the Winding Up Regulations. Therefore, it is possible for an EEA credit institution to be subject to a scheme of arrangement for the reasons discussed in more detail in respect of Chartered Corporations in Annex 9 (assuming there is sufficient connection with England). However, if the EEA credit institution is subject to winding up proceedings or reorganisation measures, and the scheme either (i) is intended to enable the EEA credit institution to survive as a going concern and affects the rights of third parties; or (ii) includes among its purposes a realisation of some or all of its assets and distributing such assets to creditors with a view to terminating the whole or any part of the business of the EEA credit institution, then the scheme can only be approved if the person proposing it has given

~~94~~105 [~~2015] EWHC 2371~~2016] EWCA Civ 1092. The decision of the Court of Appeal reverses a previous first instance decision and adopts a broader approach to recognition based on the effectiveness of the resolution measure in the relevant EEA member state. Permission has been granted to appeal to the Supreme Court.

notice to the relevant liquidator or administrator and administrative or judicial authority and no such persons have objected.

(B) Where Bank F is not an EEA credit institution:

If Bank F is not an EEA credit institution, then the qualifications in (a) to (x) below apply:

(a) A non-EEA credit institution with branches in at least two member states of the EEA would fall within the scope of certain provisions of the Winding Up Directive, but each such branch would be treated individually, the Winding Up Directive requiring (but not providing detailed guidelines for) co-operation between the relevant authorities of each member state where a branch is located. Under the Winding Up Regulations, each ~~non EEA~~non-EEA credit institution, whether or not it has a branch in another member state, may be made subject to insolvency proceedings in the United Kingdom as though it were a UK credit institution. The full implications of this approach are not yet clear, but we do not believe that it is intended that there should be a change to the basic principle of deference, in practice, to the home jurisdiction of a foreign company in which insolvency proceedings are occurring, as discussed below.

(b) Under section 221 of the Insolvency Act 1986, the English courts have jurisdiction to wind up an insolvent foreign company. Section 221 sets out certain criteria for jurisdiction in such cases, and there is also a body of case law providing additional criteria to assist a court in determining whether it is proper for it to wind up a foreign company. The decision to take jurisdiction, however, remains a matter for the discretion of the court. Among the relevant jurisdictional criteria are the presence of a branch in England and the presence of assets in England, however, neither of these must necessarily be present provided that other criteria, specified in the section 221, are satisfied.[~~95~~106]

(c) In the case of the English Branch, it is highly likely that the court will take jurisdiction to wind up Bank F if insolvency proceedings have commenced in Country H, as the English Branch is, by definition, established in England, and it is likely to have significant assets and creditors here.[~~96~~107] Note that, under section 221(4) of the Insolvency Act 1986, it is not possible for there to be a voluntary winding up of a foreign company that is a credit institution in England, and therefore the winding up will be on an involuntary basis, that is, a compulsory liquidation. 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.[~~97~~108] Since foreign companies are liable to be wound up under

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~~95~~106 Per *Dicey, Morris & Collins on The Conflict of Laws* (15th edn Sweet & Maxwell, London 2012), Rule 176(2), citing, among other cases, *Re Real Estate Development Company* [1991] BCLC 210, various criteria would guide the exercise of the court's discretion to wind up a foreign company, including that there be a sufficient connection between the company and England, there are persons who would benefit from the making of the winding up order, and there are one or more persons with an interest in the distribution of the assets of the foreign company who are subject to the personal jurisdiction of the court.

~~96~~107 Note that we discuss below the position where resolution action is taken in respect of Bank F in Country H and the resolution powers available to the English authorities in respect of Bank F in these circumstances.

~~97~~108 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.

section 221, a foreign company can also be subject to a scheme of arrangement for the reasons discussed in more detail in respect of Chartered Corporations in Annex 9 (assuming there is sufficient connection with England).

(d) In the unlikely event that the English court did not take jurisdiction to wind up Bank F in England, English insolvency law would not be relevant to the question of the enforceability of the ISDA Master Agreement in an action on the ISDA Master Agreement brought in the English courts. The netting provisions would be enforceable under English law as a matter of contract, as discussed in part V below. However, if the English court were to recognise any orders handed down by the courts of Country H following the institution of insolvency proceedings in Country H, it is possible that this could have an impact on the enforceability of the netting provisions. This is discussed further in Part IV.3(3) below.

(e) If a winding up were commenced in England in respect of Bank F, then this winding up would in principle, subject to certain qualifications and practical limitations, be conducted on a "universal" basis. In other words, as in the case of the English Bank, the English court, in conducting the winding up of Bank F, will have jurisdiction to collect all assets of Bank F (subject, of course, to the practical difficulties of collecting those assets overseas, particularly when attempting to do so in competition with the Country H liquidator) and will permit any English or foreign creditor of Bank F to prove for its claim in the English winding up, whether or not that creditor had dealt with the English branch of Bank F, subject to the "hotchpot rule" described in part IV.3(1)(c) above.

(f) The application of the universalist approach to Bank F will, of course, potentially be more problematic than in the case of the English Bank, particularly where the English liquidator attempts to collect overseas assets of Bank F in competition with the Country H liquidator.

(g) However, the universalist approach is tempered somewhat in the context of the winding up of a foreign entity. There are a number of different ways in which an English court can recognise or give assistance in relation to foreign insolvency proceedings:

(i) It is possible under the common law for the English courts to recognise foreign insolvency proceedings and provide a certain degree of assistance (such as remitting assets to the foreign proceedings) although the extent of that assistance is now uncertain following the Supreme Court decision in *Rubin v Eurofinance SA*.[~~98~~109]

(ii) Section 426(5) of the Insolvency Act 1986 also permits the English court, at the request of a foreign court in a "relevant country or territory",[~~99~~110] to apply the law of the jurisdiction of that foreign court

~~98~~109 [2012] UKSC 46. More recently in *PricewaterhouseCoopers v Saad Investments Company Limited* [2014] UKPC 36, the Privy Council supported the decision in *Rubin* and ‘modified universalism’ as it was applied in *Rubin*.

~~99~~110 Section 426(11) defines “relevant country or territory” to mean any of the Channel Islands, the Isle of Man and any country or territory designated for the purpose by order made by statutory instrument. The designated countries and territories to date are principally current and former members of the Commonwealth.

in connection with certain requests for assistance which the foreign court may make under that section. The English court may also, in its discretion, apply English law in relation to such a request and is required by section 426(5) in exercising its jurisdiction under this provision, to have regard to the rules of private international law. See part IV.3(3) below in respect of the application of section 426(5) in respect of non-netting friendly foreign insolvency proceedings.

(iii) Another statutory route to recognition of foreign proceedings is provided by the implementation in England of the Model Law on ~~cross border~~cross-border insolvency as adopted by the United Nations Commission on International Trade Law (UNCITRAL) on 30 May 1997. The UNCITRAL Model Law was implemented in England under section 14 of the Insolvency Act 2000 by the Cross Border Insolvency Regulations 2006 SI 2006/1030, which came into effect on 4 April 2006. These Regulations, however, do not apply to a UK credit institution or an EEA credit institution or any branch of either such institution as those terms are defined by regulation 2 of the Winding Up Regulations or a third country credit institution within the meaning of regulation 36 of the Winding Up Regulations.

(h) It should be noted that a distinction needs to be made between the recognition in England of any foreign insolvency proceedings *per se* and the recognition and enforcement of any judgments or orders handed down in the context of those insolvency proceedings.[~~100~~111] As you have asked us to assume that close-out netting would be enforceable in the insolvency proceedings for Bank F in Country H we do not here consider the question of enforcement in England of a non-netting friendly judgment made by a court in Country H. We consider the enforcement of judgments further in part IV.3(3) below.

(i) There is also a distinction between recognition (of proceedings or judgments) and assistance given by the English court to the foreign proceedings or liquidator. One way (developed by the case law) in which assistance can be given to a foreign insolvency proceeding is by conducting the English winding up of an overseas company as "ancillary" to the principal proceedings in Country H.

(j) The policies behind the common law concept of "ancillary" proceedings are that (a) there should be (to the extent possible) one set of universal proceedings commenced in the place of incorporation or jurisdiction with which the debtor has the closest connection; and (b) the English courts will seek the most appropriate means of ensuring substantial equality between creditors of an insolvent company in different countries. This means that where there are proceedings in Country H, the English court will generally view Country H as the most appropriate forum and will therefore require the English liquidator to remit the assets of Bank F collected by the English liquidator to the Country H liquidator so that the claims of all the creditors of Bank F may, as far as possible, be dealt with in a single set of proceedings.

~~100~~111 *Rubin v Eurofinance SA* [2012] UKSC 46

(k) The conduct of an ancillary winding up will be subject to the direction of the court. There is nothing in the insolvency legislation and no rigid rules distinguishing ancillary proceedings from an ordinary winding up, and the court will therefore give its directions to the liquidator to suit the relevant circumstances. As a matter of principle, the fact that the English proceedings are ancillary proceedings means that the English liquidator will defer to, and seek to co-operate wherever practicable with, the Country H liquidator but, as referred to below, it does not prevent English insolvency law and mandatory rules from applying in the ancillary proceedings.

(l) The court could, for example, direct the English liquidator to limit its role simply to gathering in the assets of Bank F located in England and settling a list of creditors of the English Branch.[~~101~~112] English conflict of laws rules as to the location or *situs* of assets would be relevant for the purposes of determining what assets of Bank F would be located in England. The English liquidator would then be directed to remit to the Country H liquidator the assets of Bank F collected in England, after deduction for payments of preferential debts under the Insolvency Act 1986.[~~102~~113]

(m) In such circumstances, there would be no filing of proofs in the English winding up and therefore no context or forum in England in which the question of the enforceability of close-out netting provisions under the ISDA Master Agreement could arise as a practical matter.

(n) However, even in the case of ancillary proceedings, it is possible that the liquidator could conduct more full-fledged proceedings, including the filing of proofs in England, the settling of claims and the distribution of an appropriate dividend to the creditors filing in England. In such circumstances, any surplus after remission of a full dividend to the creditors filing in England would be remitted to the Country H liquidator.

(o) The English court will not normally permit the Country H liquidator to collect directly the assets located in England of Bank F. Instead, as mentioned above, the Country H liquidator will normally receive from the English liquidator any surplus assets remaining after the completion of the English ancillary proceedings.

(p) In relation to assets of Bank F located outside of England, the fact that the English proceedings are ancillary does not preclude the English liquidator from seeking to collect some or all of those assets, although the terms of the court's original winding-up order could, as noted at (l) above, preclude the English liquidator from getting in assets located outside England without first seeking a direction from the court. Of course, as a practical matter the liquidator is not likely to seek to collect assets in Country H since the validity, and indeed

~~101~~112 *Re Hibernian Merchants Ltd.* [1958] Ch 76; see also *Re International Tin Council* [1987] Ch 419, 447, affirmed without reference to this point [1989] Ch 309 (Court of Appeal).

~~102~~113 Schedule 6 to the Insolvency Act 1986 sets out the categories of preferential debts. Preferential debts were previously limited, broadly, to unpaid contribution obligations to occupational pension schemes, certain claims of employees in relation to remuneration and unpaid levies on coal and steel production. This has now been significantly expanded in respect of credit institutions by the introduction of depositor preference. Broadly, debts due to the depositor up to the level protected by the FSCS and debts owed to the scheme manager of the FSCS rank alongside the other preferential debts and the balance forms a separate category of secondary preferential debts which rank in priority after ordinary preferential debts but ahead of floating charge holders and unsecured creditors (see section 175 Insolvency Act 1986 and Schedule 6).

precedence, of the Country H proceedings are recognised by the fact that the English proceedings are ancillary. There may be circumstances, however, in which it is appropriate for the English liquidator to collect assets of Bank F located in a foreign jurisdiction other than Country H. In practice, he would normally do so, after consultation with the Country H liquidator, in circumstances where there is some practical advantage in his seeking to collect those assets rather than the Country H liquidator's seeking to do so. It may be, for example, that the relevant jurisdiction does not recognise the Country H proceedings but does recognise the English proceedings. Or it may be that in the relevant jurisdiction an English liquidator has procedural advantages over the Country H liquidator in obtaining the co-operation of the local courts by virtue of favourable treaty arrangements between the United Kingdom and that jurisdiction.

(q) As far as the conduct of the English proceedings is concerned, English insolvency law applies to the winding up of Bank F.[~~103~~114] This is true whether or not these proceedings are conducted as ancillary to proceedings in Country H. This does not mean that foreign law will not be relevant in certain circumstances, for example, as to matters of legal capacity or the validity of claims governed by a foreign law. It does mean, however, that English law will apply to matters of substance and procedure arising during the course of the ancillary winding up. This would include the mandatory application of Rule ~~4.90~~14.25 to claims arising out of mutual dealings between a proving creditor and the overseas company. This proposition is supported by the judgment in *Re Bank of Credit and Commerce International SA (No 11)*,[~~104~~115] where the Vice-Chancellor Sir Richard Scott held, amongst other things, that:

   (i) the ancillary character of an English winding up did not relieve an English court of the obligation to apply English law; and

   (ii) English insolvency law should be applied to the resolution of any issue arising in an English winding up (ancillary or not) that is brought before the court and that this includes the mandatory application of Rule 4.90 of the Insolvency Rules 1986.[116]

(r) Accordingly, in the ancillary winding up in England of Bank F, the analysis in part IV.3(1) in relation to the English Bank would apply were the question of the enforceability of the close-out netting provisions under the ISDA Master Agreement to arise during the winding up of Bank F in England.

(s) There could be circumstances where the English court would not direct that the winding up of Bank F be conducted as ancillary proceedings. For example, contrary to our assumption, there might be no Country H proceedings. Alternatively, there might be Country H proceedings, but the English court might nonetheless decline to conduct the winding up as ancillary to the Country H proceedings because:

~~103~~114 *Dicey, Morris & Collins* (note ~~95~~106), Rule 178(2). The explanation in *Dicey* notes that Rule 178(2) is not modified even where the English winding up is expressed as ancillary to the insolvency proceedings abroad.

~~104~~115 [1996] 4 All ER 796.

116 Rule 4.90 of the Insolvency Rules 1986 was the predecessor to Rule 14.25 of the Insolvency (England and Wales) Rules 2016.

(i) English creditors would be disadvantaged in the Country H proceedings relative to local creditors, for example, by ranking behind rather than *pari passu* with local creditors in those proceedings; or

(ii) the court refuses to recognise the Country H proceedings on one of the following grounds: the foreign proceedings are instituted or conducted in a manner contrary to English public policy or principles of natural justice; the foreign proceedings are fraudulent in some respect; or recognition of the foreign proceedings would result in the enforcement in England of a foreign penal or revenue law.

(t) In such a case, the winding up of Bank F would be conducted in the same manner as the involuntary winding up of the English Bank, although as a practical matter the English liquidator would probably be subject to greater constraints in collecting overseas assets. The winding up in England of Bank F would be conducted in principle, subject to certain qualifications and practical limitations, on a universal basis, and English insolvency law would apply to matters of substance and procedure. As indicated above, this would include the mandatory application of Rule ~~4.90~~14.25. Accordingly, the analysis above in this part IV in relation to the English Bank would apply to the question of the enforceability of the close-out netting provisions under the ISDA Master Agreement.

(u) We do not believe that there are any circumstances in which an English liquidator could claim that an amount was due under the ISDA Master Agreement to the English Branch free from the effect of the close-out netting provisions of Section 6(e) as analysed in part III above.

(v) In this context, it is worth noting the comment of Browne-Wilkinson VC in *Re Bank of Credit and Commerce International S.A.*,[~~105~~117] that an "attempt to put a ring fence around either the assets or the creditors to be found in any one jurisdiction is, at least under English law as I understand it, not correct and destined to failure."

(w) In other words, we do not consider that there is any basis under English law on which the English liquidator conducting winding up of Bank F in England could take action adversely affecting the enforceability in Country H of close-out netting under the ISDA Master Agreement.

(x) This view is supported by the case of *MacFarlane v Norris*.[~~106~~118] In that case, a creditor was indorsee and holder of a bill of exchange accepted by the debtor. The debtor became bankrupt in Scotland. The creditor owed the bankrupt the proceeds of sale of goods sold by the creditor on behalf of the bankrupt. Under the law of Scotland, there was an insolvency set-off. The Scots trustee sued the creditor in England. The English court held that there was a set-off. There would have been a set-off under both English and Scots law, but it seems that the court applied Scots law as the law of the place where the bankruptcy proceedings were taking place.

~~105~~117 [1992] BCLC 570, 577.

~~106~~118 (1862) 2 B&S 783.

(C) Where Bank F is not an EEA credit institution – Resolution ~~Proceedings~~Action:

(a) When facing an English Branch of Bank F where Bank F is not an EEA credit institution, consideration should also be given to the application of the Banking Act to the English Branch. The Banking Act and the SRR is discussed in more detail in the annexes to this memorandum as it applies to the particular English Counterparty under consideration. Annex 1 to this memorandum discusses the application of the Banking Act to an English Bank and certain terms defined in Annex 1 are used in the discussion that follows.

(b) The powers under Part 1 of the Banking Act can be exercised, subject to certain modifications, 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**).[~~107~~119]

(c) Where, pursuant to section 89H of the Banking Act, the Authorities choose to recognise a Third Country Resolution Action, in whole or in part, the Bank of England must make a statutory instrument. Section 89I(3) states that "[f]or the purposes of supporting, or giving full effect to, the [Third Country Resolution Action] (or the part)", the Bank of England may exercise, in relation to a Third Country Institution, one or more of the stabilisation options or one or more of the stabilisation powers available to the Bank in relation to a similar entity in the United Kingdom. Section 89I(4) states that, for the purposes of exercising a power pursuant to section 89I(3), provision which could otherwise be made under a mandatory reduction instrument, share transfer instrument, property transfer instrument or resolution instrument may instead be made in the instrument made under section 89H recognising the Third Country Resolution Action (or part) or a further instrument made by the Bank of England under section 89I (a "third country instrument").

(d) The regime in respect of Third Country Institutions was introduced by the BRR Order 2014. It remains to be seen how these powers will be exercised by the Authorities. However, section 89I(3), as discussed above, makes it clear that the stabilisation options and 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 Annex 1 to this memorandum in respect of an English Bank.

~~107~~119 See Chapter 6 (Third-country Resolution Actions) of the Banking Act~~. See also Part XII 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~~.

(e) Moreover, section 89I(3) of the Banking Act makes it clear that such tools are available to the Authorities for the specific purpose of supporting or giving effect to the Third Country Resolution Action. Section 89I(6) amends section 4 (Special resolution objectives) for the purposes of the application of Part 1 of the Banking Act to Third Country Institutions to include a subsection 9(A), which adds an additional special resolution objective as follows:

> "Objective 8 is to support third-country resolution action with a view to promoting objectives which, in relation to the third country concerned, correspond to Objectives 1 to 7 in relation to the United Kingdom."

The Treasury's consultation[~~108~~120] on the implementation of these provisions suggests that third country instruments may apply to: (i) assets of the Third Country Institution or its group located in the UK or governed by UK law; and (ii) rights or liabilities of the Third Country Institution that are booked by its UK branch or governed by UK law. Accordingly, it seems that the exercise of these powers under the Banking Act in respect of a Third Country Institution is possible only where the relevant Authorities are acting to support or give full effect to the Third Country Resolution Action carried out by the relevant third country resolution authority, and only to the extent necessary to support such Third Country Resolution Action, and actions of the Authorities may include actions such as transferring assets located in the United Kingdom to a purchaser under the equivalent in the foreign jurisdiction of a sale of business tool, or to a bridge bank in the relevant jurisdiction.

(f) However, it should be noted that, where a third country instrument under the Banking Act recognises a Third Country Resolution Action (or a part of it), in addition to the availability of the stabilisation options and stabilisation powers in respect of the Third Country Institution, under section 89I(2) such Third Country Resolution Action (or part of it) "produces the same legal effects in any part of the United Kingdom as it would have produced had it been made (with due authority) under the law of that part of the United Kingdom." 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.[~~109~~121] However, the nature and effect of the recognised Third Country Resolution Action is ultimately a question for the relevant foreign law.

(g) 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

~~108~~120 See, for example, paragraph 2.74 of the HM Treasury publication entitled "Transposition of the Bank Recovery and Resolution Directive: response to the consultation" of March 2015.

~~109~~121 See definition of "third country resolution action" in section 89H(7) of the Banking Act.

made in a property transfer order and constitutes a partial property transfer. The protections provided by the Partial Property Safeguards Order are discussed in more detail in Annex 1 in respect of English Banks.

(h) In addition to the effect of recognition under section 89I(2) and the Bank of England's powers under 89I(3), section 48Z will also apply where the Bank of England (x) recognises a Third Country Resolution Action (or part of such action) or (y) exercises its powers under section 89I(3).

Section 48Z of the Banking Act is discussed in more detail at Annex 1 as it applies to English Banks. In summary, the right to terminate and close-out Transactions in accordance with the close-out netting provisions may be ineffective where such rights arise as a result of certain specified events including a recognised Third Country Resolution Action or action by the Bank of England under section 89I(3) in relation to the Third Country Institution or a member of its group (as defined in section 474 of the Companies Act 2006).

However, the right to terminate and close-out Transactions 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.

(i) Note that above we discuss the position with respect to Third Country Institutions but the Banking Act also provides for the recognition of resolution action in respect of third country parent undertakings and the application of the group company powers in respect of third country group companies.

(j) In addition, the Bank Recovery and Resolution Order 2016[122] (the **BRR Order 2016**), implementing Article 96 of the BRRD, introduces a new section 89JA of the Banking Act, which provides the Bank of England with back-stop powers to act independently to resolve a UK branch by applying relevant parts of the SRR, subject to modifications. A "UK branch" is a branch located in the United Kingdom of a Third Country Institution authorised for the purposes of the Financial Services and Markets Act 2000 by the PRA or the FCA. Broadly, the Bank of England's powers in this regard are limited to transferring the property, rights and liabilities of the branch and the power to bail in transferred liabilities. "Special bail-in provision" for these purposes means provision (i) modifying or changing the form of a relevant liability or (ii) provision that a contract under which the relevant institution has a relevant liability is to have effect as if a specified right had been exercised under it (and, in either case, associated provision).[123] The BRR Order 2016 extends the safeguards that apply in connection with the exercise of the partial property transfer and bail-in powers for firms established in the UK to the case of branch resolution (see Annex 1 for further details regarding the relevant safeguards).[124]

122 SI 2016/1239.

123 For these purposes, "relevant liability" means a liability of the Third Country Institution or resolution company which is transferred in the property transfer instrument which makes special bail-in provision and "relevant institution" means the Third Country Institution whose liabilities are so transferred.

124 Article 36 of the BRR Order 2016 amends the definition of "banking institution" in the Partial Property Safeguards Order to include "a third-country institution (within the meaning of section 89JA of the [Banking Act] (resolution of UK branches of third-country institutions)" and inserts a new article 1(3)(5) that states: "[r]eferences in this Order to sections of the [Banking Act] include, as the context requires, references to those provisions as applied with or without modifications by that Act, as that Act has effect on the day

(3) *As indicated above thus far ISDA has obtained legal opinions indicating that bilateral and multibranch close-out netting would be enforceable in numerous jurisdictions. However, ISDA would like you to confirm that where courts in your jurisdiction have jurisdiction over the assets of a bank organised in your jurisdiction or a Local Branch, a multibranch master agreement such as the ISDA Master Agreement would be treated as a single, unified agreement by an insolvency official under the laws of your jurisdiction regardless of the treatment of the ISDA Master Agreement or Transactions thereunder by an insolvency official in a jurisdiction where close-out netting may be unenforceable.*

Under the Winding Up Regulations there would be no separate insolvency proceedings in England in respect of an English Branch of an EEA credit institution. Therefore, this part IV.3(3) addresses an English Bank and an English Branch of a ~~non EEA~~non-EEA credit institution only.

(a) Subject to the questions in paragraphs (c) and (d) below, in reaching the conclusions in part IV.3(1), it is not necessary to assume that the close-out netting provisions of the ISDA Master Agreement are enforceable under the laws of any jurisdiction where a branch of the English Bank is located. In assumption (g) in part III.2, we assumed that the ISDA Master Agreement is enforceable under its governing law. (We discuss the enforceability of an English law governed ISDA Master Agreement as a matter of general law, including the law of contract in part V.) English insolvency law governs insolvency proceedings in relation to the English Bank in England, subject to a few exceptions, as discussed above in this part IV. There is no principle of English law, including English conflict of laws rules, that would require an English court to consider the validity of the netting provisions of the ISDA Master Agreement under the laws of a foreign jurisdiction simply because a Transaction under the ISDA Master Agreement was booked in a branch of the English Bank located there. In other words, our conclusion in part IV.3(1) holds true even if a branch of the English Bank is located in a jurisdiction where close-out netting is either not enforceable or where there is material doubt as to its enforceability (a **Non-Netting Jurisdiction**).

(b) Subject to the questions in paragraphs (c) and (d) below, in reaching the conclusions in part IV.3(2) in respect of the English ~~branch~~Branch of a ~~non EEA~~non-EEA Credit Institution, it is not necessary to assume that the close-out netting provisions of the ISDA Master Agreement are enforceable under the laws of any foreign jurisdiction where a branch of Bank F is located other than Country H. In assumption (g) in part III.2, we assumed that the ISDA Master Agreement is enforceable under its governing law. English insolvency law would govern the winding up in England of Bank F, assuming it is not an EEA credit institution, whether or not conducted as ancillary to proceedings in Country H. There is no principle of English law, including English conflict of laws rules, that would require an English court to consider the validity of the netting provisions of the ISDA Master Agreement under the laws of a foreign jurisdiction simply because a Transaction under the ISDA Master Agreement was booked in a branch of Bank F located there or because Bank F is also subject to insolvency proceedings there. In other words, our

on which the [BRR Order 2016] comes into force." Article 39 of the BRR Order 2016 extends the definition of "banking institution" in the Bail-in Safeguards Order in the same manner as article 36. Article 39 also amends article 2(2) of the Bail-in Safeguards Order to state that "[r]eferences to sections of the [Banking Act] include, as the context requires, those sections as applied with or without modifications by that Act, as that Act has effect on the day on which the [BRR Order 2016] comes into force."

conclusion in part IV.3(2) holds true even if a branch of Bank F, other than its head office in Country H, is located in a Non-Netting Jurisdiction.

(c) Are there any actions that a foreign liquidator in a Non-Netting Jurisdiction could take to disrupt close-out netting in England under an ISDA Master Agreement entered into with an English Bank on a Multibranch basis or with an English branch of Bank F? Could he, for example, seek an order from the English court asking the court to declare the netting under the ISDA Master Agreement ineffective on the basis that it would be unenforceable under the laws of the Non-Netting Jurisdiction? Or could he seek recognition of an order of the court of the Non-Netting Jurisdiction to this effect? Or could he, for example, sue successfully in the English courts to recover the gross or net amount due to (i) the local branch of Bank F in that Non-Netting Jurisdiction or (ii) the local branch of an English Bank in that Non-Netting Jurisdiction in each case under Transactions booked in that local branch (the **Local Branch Amount**), leaving the solvent party to claim in the Country H liquidation or in the English proceedings, as applicable, for the net amount due to it in relation to all other Transactions? Whether the Local Branch Amount would be gross or net would depend on whether the local liquidator, after "ring-fencing" Transactions with the local branch of Bank F or the English Bank, as applicable, would permit netting amongst those Transactions or would "cherry-pick" the termination values favourable to the local branch.

(d) Or could he obtain a monetary judgment against the solvent party in the Non-Netting Jurisdiction in relation to the Local Branch Amount and then enforce that judgment in England?

(e) In our view, and depending on the facts, there is a risk that the liquidator in the Non-Netting Jurisdiction could bring an action in England that could have the effect of disrupting the netting contemplated by Section 6(e) of the ISDA Master Agreement although we consider that an English court would strive to find ways of giving effect to the netting. Our concerns arise primarily from section 426 of the Insolvency Act 1986 and the possibility of a foreign judgment being enforced in England in certain circumstances. The risk is lessened in circumstances where the assistance or relief sought by the liquidator in the Non-Netting Jurisdiction relates to an ISDA Master Agreement that would constitute a financial collateral arrangement, or is part of an arrangement of which a financial collateral arrangement forms part, for the purposes of the FCA Regulations.

(f) Considering each of these concerns in turn:

(i) As noted above, section 426 of the Insolvency Act 1986 would, if the Non-Netting Jurisdiction is a designated country for this purpose under the Act, permit a court in that jurisdiction (not the local liquidator itself) to seek the assistance of the English courts in relation to the local proceedings. Section 426 is broadly drafted, provides little guidance and grants the English court a great deal of discretion in deciding what form of assistance to provide. Section 426(5) would permit but not require the English court to apply the law of the Non-Netting Jurisdiction in certain circumstances, having regard "in exercising its discretion under this subsection ... in particular to the [English] rules of private international law".

There is no clarification by way of statutory instrument as to the application of section 426 and a limited amount of case law. However, it does not seem likely that an English court would apply foreign law under this section to overturn the effect of the close-out netting contemplated by the ISDA Master Agreement. An English court is more likely to apply foreign law, for example, to invalidate Transactions under a doctrine of foreign law comparable to our rules about preferences or transactions at an undervalue than to apply it to override a policy as fundamental to our insolvency law as insolvency set-off. It is not, however, possible to be definitive on this point. As noted above, section 426 is currently available only to a limited number of present and former members of the Commonwealth.

Furthermore, we consider that an English court is less likely to be disposed to assist a foreign liquidator seeking to overturn the effect of the close-out netting in the case of:

(i) an English Bank given the English court will view England as the proper and natural forum for the principal liquidation proceedings;

(ii) a branch of ~~a~~ Bank F where English proceedings have commenced, particularly given the mandatory nature of rule ~~4.90~~14.25; and

(ii) a foreign court requesting assistance in respect of Bank F located in a jurisdiction other than Country H (assuming that Country H is Bank F's centre of main interests), which the English court will view as the proper and natural forum for the principal liquidation proceedings in relation to Bank F.

Whilst there is a limited amount of case law that is directly relevant in respect of the scope of section 426, we note that in *Re Pan Ocean Ltd*~~[110]~~[125] the court considered a request from a Korean liquidator that the court could and should make an order restraining a Brazilian company from relying on a termination clause triggered by insolvency.

~~110~~125 [2014] EWHC 2124 (Ch) (Also known as *Fibria Celulose S/A v Pan Ocean Co Ltd*)

The relevant cross-border regime in that case was the Cross Border Insolvency Regulations (discussed above) rather than section 426. The court held that it did not have the power to grant the relief under those Regulations. However, the judge also considered whether he would have granted the restraining order had the power been available and noted:

> ''[...] in the present case, the parties had deliberately chosen English law as the law of the contract. Whereas the parties might have expected that a Korean court would apply Korean insolvency law to the insolvency of the Company, they might have been very surprised to find that an English court would apply Korean insolvency law to the substantive rights of the parties under a contract which they had agreed should be governed by English law.
>
> Different jurisdictions adopt different approaches to *ipso facto* clauses. I have referred earlier to the position in the United States, Canada and Korea. As it happens, the position in English law has been recently reviewed by the Supreme Court in *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd*. The Supreme Court took full account of the policy considerations behind the choice which is to be made as to the enforceability of such provisions. If Korean law is as the administrator contends, then Korea views these policy questions differently from this jurisdiction. If I have a free hand, as the administrator contends, to do what I consider to be appropriate in this case, I am not tempted to prefer the policy choice which is made in Korean law over the policy choice recently reaffirmed by the Supreme Court in relation to English law. In this case, I consider that it is appropriate for the Companies Court to apply English law and to give effect to the parties' choice of English law.''

Whilst clearly the reasoning in *Re Pan Ocean* is not directly applicable, a similar argument could be made that the English court should not exercise its discretion under section 426 to apply a foreign law where the result would be to overturn the effect of close-out netting in an English law governed ISDA Master Agreement (or the effect of rule ~~4.90~~14.25). However, as noted above, the statutory test in the Cross Border Regulations is different from section 426(4). Section 426(4) provides that the English courts 'shall assist' a court with appropriate insolvency jurisdiction in a relevant jurisdiction whereas article 21(1) provides that the English court 'may, at the request of the foreign representative, grant any appropriate relief'.

(ii) The question of the enforceability in England of a judgment obtained in a court of the Non-Netting Jurisdiction in relation to the Local Branch Amount is, unfortunately, not straightforward. A judgment of the local court 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[~~111~~126] 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.

If a foreign judgment has been properly obtained, it will not be re-examined on its merits in the English courts, subject, however, to exceptions relating to jurisdiction, natural justice (due process), fraud and English public policy. [~~112~~127] The case law suggests, however, that public policy is to be construed narrowly. As a matter of public policy, a foreign judgment will not be recognised by the English courts if it is inconsistent with a decision of a competent English court in previous proceedings between the same parties.[~~113~~128] There appears to be no reported case applying this rule where the relevant proceedings are winding up proceedings, however, there seems to be no reason why it should not apply. Logic and common sense suggest that an English court would not enforce a judgment that is inconsistent with its own winding up of Bank F, including the application of mandatory insolvency set-off.

Whilst we note that your question primarily relates to the treatment of the ISDA Master Agreement where English insolvency proceedings have commenced, the position is more uncertain where there is no English winding up or other English proceedings in which the issue of the enforceability of the close-out netting provisions under the ISDA Master Agreement has been adjudicated. An English court might enforce a foreign judgment obtained by the liquidator in the Non-Netting Jurisdiction in certain circumstances, based on common law principles or on the basis of relevant statutory provisions and treaty obligations. This is not a question of applying or deferring to foreign insolvency law, but simply recognising in England the effect of a foreign monetary judgment. Much may depend on the nature of the judgment in question. If, for example, the foreign liquidator is claiming that a party contracting with Bank F owes a particular sum

~~111~~126 In *Rubin v Eurofinance SA* [2012] UKSC 46, the Supreme Court considered what it referred to as Dicey Rule 36 (after the rule in Dicey, Morris and Collins, note ~~95~~106, now to be found at Rule 43) whereby for a foreign monetary judgment to be enforceable in England, the defendant must have been present in the foreign jurisdiction at the time of the foreign proceedings, a claimant or counter-claimant in those proceedings or must have submitted (or agreed to submit) to the foreign jurisdiction.

~~112~~127 See for example, *Soleimany v Soleimany* [1999] QBB 785 in respect of the common law, section 4 of the Foreign Judgments (Reciprocal Enforcement) Act 1933, section 9(2) of the Administration of Justice Act 1920, Article 34(1) of the 2001 Brussels Regulation, Article 45(~~a~~1) of the Recast Brussels Regulation, Article 34(1) of the 2007 Lugano Convention, Article 27 of the 1988 Lugano Convention~~ and~~, Article 50 of the Brussels Convention 1968 and Article 9(e) of the Hague Convention on Choice of Court Agreements.

~~113~~128 *ED&F Man (Sugar) Ltd v Haryanto (No. 2)* [1991] 1 Lloyd's Rep. 429 (CA) and also see the Comment to Rule 51 in *Dicey, Morris & Collins* (note ~~95~~106).

of money to Bank F because the netting provisions are contrary to local insolvency law, that is likely to constitute a monetary judgment and recognition under the common law or relevant statutory route may be available. It is possible, however, that the party would still be able to raise the netting provisions as a defence to payment in England. If, on the other hand, the foreign liquidator is claiming that the party owes a particular sum of money to Bank F because the liquidator has the right to claw back certain payments made by Bank F prior to the commencement of the foreign insolvency proceedings, it may be much more difficult for the party to resist an enforcement of that foreign monetary judgment in England if the conditions for recognition under the common law or relevant statutory regime are met.

The English court has, however, the jurisdiction to stay the execution of the English judgment enforcing a foreign judgment in certain circumstances including public policy. Whilst the Court of Appeal has made it clear that getting a stay will not be a straightforward matter, it is possible (although by no means certain) that the party may be able to obtain a stay of the judgment where the judgment relates to a claim validly netted under an ISDA Master Agreement that is otherwise enforceable on the basis of the assumptions and qualifications above.

(iii) Regulation 15A of the FCA Regulations provides that, in respect of a financial collateral arrangement, the references to 'insolvency law' in section 426 include, in respect of a relevant country so much of the law of that country as corresponds to Part 3 of the FCA Regulations. It is not wholly clear but this may mean it is not open to the court to apply foreign law under section 426(5) where the foreign law is contrary to the FCA Regulations. In any event, Regulation 15A(2) 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 a 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.[~~114~~129] It is worth noting,

[~~114~~129] Note that Regulation 15A(2) does not affect the recognition of a judgment required to be recognised under the Civil Jurisdiction and Judgments Act 1982 or the Brussels Regulation. The Civil Jurisdiction and Judgment Act, *inter alia*, gives force to various international conventions including the Brussels Conventions, the Lugano Conventions and the Hague Convention.

however, that there is no case law yet on how Regulation 15A would be applied in practice.

(g) Separately, we note here again for completeness the possibility that the Authorities may exercise the powers in Part 1 of the Banking Act in respect of a Third Country Institution pursuant to section 89I of the Banking Act. As outlined at part IV.3(2) above, the availability of such powers in respect of the Third Country Institution is limited to the extent that they would be available in respect of a similar entity in the United Kingdom and this principle is not affected by a branch of Bank F, other than its head office in Country H, being located in a Non-Netting Jurisdiction. However, in addition to the availability of such powers, where a third country instrument under the Banking Act recognises a Third Country Resolution Action (or a 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.~~[115]~~[130]

~~115~~130 Section 89I(2) of the Banking Act.

V. ENFORCEABILITY IN THE ABSENCE OF INSOLVENCY PROCEEDINGS

1. Introduction

The principal focus of the Instruction Letter is on the enforceability of the close-out netting provisions of the ISDA Master Agreement against an English Counterparty, including an English Counterparty that is a Multibranch Party, in the event of its being subject to insolvency proceedings in England.

As English law is one of the two choices of governing law contemplated by Section 13 of the ISDA Master Agreement (the other choice being the laws of the State of New York), to be elected by the parties to the ISDA Master Agreement, normally by specifying the governing law in Part 4 of the Schedule, you have asked us also to opine on the validity and enforceability under English law of the ISDA Master Agreement, including the close-out netting provisions in the absence of insolvency proceedings in relation to a Counterparty.

We set out below our view on whether the ISDA Master Agreement, including the close-out netting provisions, assuming that it is governed by English law, would be valid and enforceable under English law against an English Counterparty or against a Counterparty that is a Foreign Entity within the scope of this memorandum, in the absence of insolvency proceedings or resolution action in relation to either party.

2. Assumptions

For the purposes of this part V, our assumptions in part III.2 above apply other than assumption (g) and (~~i~~j). Our conclusions would not be affected if assumption (a) or (b) in part IV.2 above also applied.

We have, however, also made the following additional assumptions:

(a) each party is able lawfully to enter into and has taken all corporate action necessary to authorise entry into the relevant ISDA Master Agreement and each Transaction under that ISDA Master Agreement; and

(b) insofar as any obligation under an ISDA Master Agreement 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.

3. Conclusion

On the basis of the assumptions above and the qualifications below, in the absence of insolvency proceedings or resolution action in relation to a Counterparty, including a Counterparty that is a Foreign Entity within the scope of this memorandum, we are of the view that the ISDA Master Agreement, including the close-out netting provisions, would be valid and enforceable under English law against the Counterparty.

4. Qualifications

The foregoing conclusion is subject to the following qualifications:

(1) 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. The term does not address the extent to which a judgment obtained in a court outside England will be enforceable in England. Nor does it mean that each obligation will be enforced in accordance with its terms. Certain rights and obligations may be qualified by the nature of the remedies available in the English courts, the acceptance by such courts 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. In particular, 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.

(2) There is no judicial authority for the validity of the Contractual Currency provision set out in Section 8 of the ISDA Master Agreement. We do not believe that the currency indemnity in Section 8 of the ISDA Master Agreement would be effective to cover currency losses relating to movements in currency rates occurring after the winding up order.

(3) The choice of English law as the governing law of the ISDA Master Agreement would be upheld as a valid choice by the courts of England subject to and in accordance with Regulation (EC) No 593/2008 of 17 June 2008 on the law applicable to contractual obligations (**Rome I**) and provided that the relevant contractual obligation is within the scope of and the choice is permitted by Rome I.

(4) 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, 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.

~~We also assume neither party is entitled to immunity under English law.~~

(5) Any term of the ISDA Master Agreement may be amended orally by the parties notwithstanding Section 9(b) of the ISDA Master Agreement.

(6) The Interest and Compensation provisions set out in Section 9(h) of the 2002 Agreement provide for interest to be paid on overdue amounts. Such interest and the

Default Interest provision of the 1992 Agreement may amount to a penalty under English law and may therefore not be recoverable.[131]

(7) Any provision of the ISDA Master Agreement that purports to include an indemnity for costs of litigation is subject to the discretion of the court to decide whether and to what extent a party to litigation should be awarded the costs incurred by it in connection with the litigation.

(8) Any provision of the ISDA Master Agreement stating that a failure or delay, on the part of any party, in exercising any right or remedy under the ISDA Master Agreement shall not operate as a waiver of such right or remedy may not be effective.

(9) There could be circumstances in which an English court would not treat as conclusive a certificate or determination or other evidence or statement that the ISDA Master Agreement states is to be so treated.

(10) A payment obligation under a Transaction governed by the ISDA Master Agreement will be unenforceable under English law if (i) it involves the currency of any member of the International Monetary Fund and (ii) it is contrary to the exchange control regulations of any member of the International Monetary Fund that are maintained or imposed consistently with the International Monetary Fund Agreement.

(11) To the extent that any provision of the ISDA Master Agreement purports to be an undertaking by a party to assume liability on account of the absence of payment of United Kingdom stamp duty or an undertaking to pay United Kingdom stamp duty, such provision may be void.

(12) Any provision of the ISDA Master Agreement that provides for deemed receipt of notices may be ineffective if a party has actual evidence of non-delivery.

(13) The effectiveness of an entire agreement clause is subject to the English courts being satisfied that, as a matter of fact, there was no additional term which the parties intended to form part of the agreement.

(14) In respect of the Bank of England and the United Kingdom acting through ~~her~~Her Majesty's Treasury, this is subject to political risk and sovereign immunity (as discussed in Annexes ~~16~~18 and ~~17).~~ 19). For the purposes of this part V we assume neither party is entitled to immunity under English law.

[131] Following the Supreme Court decision in *Cavendish Square Holding BV v Talal El Makdessi; ParkingEye Limited v Beavis* [2015] UKSC 67, the test to be applied is whether the provision in question "is a secondary obligation which imposes a detriment on the contract-breaker out of all proportion to any legitimate interest of the innocent party in the enforcement of the primary obligation".

VI. KEY DIFFERENCES BETWEEN THE 1992 AGREEMENT AND 2002 AGREEMENT

1. *We ask that you confirm that the inclusion of the Force Majeure Event would not affect your opinion. If the inclusion of this provision would affect your opinion, please set forth the legal implications. Please note that this is not a request for advice on force majeure and impossibility issues generally under the laws of your jurisdiction, but merely whether the inclusion of the Force Majeure Event would affect your opinion on the enforceability of the termination, close-out netting and multibranch netting provisions of the 2002 Agreement.*

   The inclusion of a Force Majeure Event does not affect our conclusions in this memorandum in respect of the 2002 Agreement.

2. *Please confirm that the inclusion of Close-out Amount in lieu of the prior choice between Market Quotation and Loss would not affect your opinion on the enforceability of the termination, close-out netting and multibranch netting provisions of the 2002 Agreement.*

   The inclusion of Close-out Amount in lieu of a choice between Market Quotation and Loss does not affect our conclusions in this memorandum in respect of the 2002 Agreement.

3. *We are not asking you to opine on the enforceability of Section 6(f), but to confirm that the inclusion of Section 6(f) would not affect your opinion on the enforceability of the close-out netting provisions of the 2002 Agreement.*

   The inclusion of Section 6(f) does not affect our conclusions in this memorandum in respect of the 2002 Agreement. As requested, we do not in this memorandum give any opinion on the validity and enforceability under English law of Section 6(f) of the 2002 Agreement itself.

VII. THE 1987 AGREEMENT

Please indicate how, if at all, your conclusions in relation to the 1987 Agreement would vary relative to your conclusions in relation to the 1992 Agreement and 2002 Agreement.

1. Our analysis and conclusions in this memorandum apply in relation to the 1987 Agreement, subject to the following:

   (a) We have assumed in part III.2 above that:

      (i) Section 6(e)(i)(1) of the 1987 Agreement has been amended *mutatis mutandis* so that its substantive effect is the same as Section 6(e)(i)(2), namely, to provide that the Non defaulting Party shall pay the Defaulting Party where the Defaulting Party is "in the money" on a net basis (and after taking into account Unpaid Amounts); and

      (ii) for the purpose of answering the question in part III.3(1), the 1987 Agreement has been expressly amended to delete the second sentence of Section 6(a) providing for the deemed occurrence of an Early Termination Date in the case of a Bankruptcy Event of Default.

   (b) Given that the 1987 Agreement does not contemplate the inclusion of physically settled Transactions, we assume that if physically-settled Transactions are included under a 1987 Agreement, suitable amendments have been made to its terms to reflect this, including consequential amendments to Sections 5 and 6 of the relevant 1987 Agreement. For example, we assume that deliveries that were to be made prior to the designation or deemed occurrence of an Early Termination Date and were not in fact made are converted into a monetary obligation in the same manner as provided for in the 1992 Agreement and 2002 Agreement.

   (b) Section 5(a)(vii) of the 1987 Agreement is broadly drafted and includes some events that are likely to be uncertain as to the precise time of their occurrence (principally the events referred to in sub-clauses (2), (7) and (8)). This uncertainty could be sufficiently great as to raise a question about the enforceability of the second sentence of Section 6(a), which provides for the deemed occurrence of an Early Termination Date automatically upon the occurrence of an event falling within the Bankruptcy Event of Default.[~~116~~132] For example, although it will be clear when a petition for a winding up order has been filed, it will be unclear generally whether the deemed occurrence of the Early Termination Date took effect with respect to an event falling within sub-clause (2) at some time preceding the filing.

   In contrast, Automatic Early Termination under the 1992 Agreement and 2002 Agreement, if elected, does not apply to those events that are uncertain as to the precise time of their occurrence. Therefore, the enforceability of Automatic Early Termination in the 1992 Agreement and the 2002 Agreement cannot be called into question on the basis of the uncertainty created by the inclusion of the events in the 1992 Agreement and 2002 Agreement equivalent to those in the 1987 Agreement referred to above.

2. In addition, we note that:

~~116~~132 This is equivalent to Automatic Early Termination under the 1992 Agreement and the 2002 Agreement, although that term is not used in the 1987 Agreement.

(a) the single agreement provision is provided for in the preamble to the 1987 Agreement rather than in Section 1(c) as in the case of the 1992 Agreement and 2002 Agreement;

(b) the 1987 Agreement refers to "Swap Transactions" rather than "Transactions";

(c) the 1987 Agreement does not contain a provision equivalent to Section 10(a) of the 1992 Agreement or 2002 Agreement; and

(d) under the 1987 Agreement, termination values are determined by reference to Market Quotations and, if market quotations are unavailable, then by reference to a non-defaulting party's Loss.

3. Although this memorandum should be read with these differences in mind, we do not think that they materially affect our conclusions on the issues discussed in this memorandum.

VIII. THE 2001 ISDA CROSS-AGREEMENT BRIDGE

Please state whether the inclusion of the 2001 Bridge would materially affect the conclusions reached in your opinion. Please note that we are not asking you to confirm the validity or enforceability of the 2001 Bridge under the laws of your jurisdiction.

We have reviewed the 2001 Bridge and confirm that the inclusion of the 2001 Bridge would not materially affect the conclusions reached in this memorandum. As requested, we do not in this memorandum give any opinion on the validity or enforceability under English law of the 2001 Bridge itself.

IX. THE 2002 ISDA ENERGY BRIDGE

Please state whether the inclusion of the 2002 Bridge would materially affect the conclusions reached in your opinion. Please note that we are not asking you to confirm the validity or enforceability of the 2002 Bridge under the laws of your jurisdiction.

We have reviewed the 2002 Bridge and confirm that the inclusion of the 2002 Bridge would not materially affect the conclusions reached in this memorandum. As requested, we do not in this memorandum given any opinion on the validity or enforceability under English law of the 2002 Bridge itself.

X. THE ISDA CLOSE-OUT AMOUNT PROTOCOL

Please state whether the amendment of a 1992 Agreement pursuant to the Close-out Amount Protocol would materially affect the conclusions reached in your opinion. Please note that we are not asking you to confirm the validity or enforceability of the Close-out Amount Protocol under the laws of your jurisdiction.

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 conclusion in this memorandum regarding the enforceability of that ISDA Master Agreement, including the close-out netting provisions, would not be materially affected.

We are of the view that the Close-out Amount Protocol is effective to amend an ISDA Master Agreement governed by English law falling within its scope in accordance with the terms of the Close-out Amount Protocol.

XI. THE JUNE 2014 AMENDMENT TO THE ISDA MASTER AGREEMENT IN RELATION TO SECTION 2(a)(iii)

Please state whether the amendments to an ISDA Master Agreement set out in the June 2014 Section 2(a)(iii) Amendment would materially affect the conclusions reached in your opinion.

We have reviewed the amendments set out in the Attachments to the June 2014 Section 2(a)(iii) Amendment.

We confirm that if a 1992 Agreement or a 2002 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 Attachment applicable to that form of ISDA Master Agreement, our conclusion in this memorandum regarding the enforceability of that ISDA Master Agreement, including the close-out netting provisions, would not be materially affected.

XII. PENDING DEVELOPMENTS

Please state whether there any pending developments (such as proposed legislation) that are likely to have a material impact on the conclusions reached in your opinion.

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 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).~~ The implementation of the BRRD continues and may necessitate further changes to the UK framework. The Commission Delegated Regulation under Article 76, which entered into force on 9 June 2017 and which is discussed in more detail at Annex 1 to this memorandum, circumscribes the scope of protection for netting and set-off arrangements in a partial property transfer scenario making the Partial Property Safeguards Order, in its current form, inconsistent with the level 2 measures. Furthermore we note that, on 23 November 2016, the European Commission published proposals to amend certain aspects of the BRRD (the **BRRD2 Proposals**), which may mean that that certain provisions of the SRR may be amended in due course. The main objective of the BRRD2 Proposals is to implement the globally-agreed Total Loss-absorbing Capacity ("TLAC") standard and to integrate the TLAC requirement into the MREL requirement mandated by the BRRD. We note that derivatives liabilities are excluded from TLAC and MREL. However, there are also a number of other aspects of the BRRD which are impacted by the proposals. Recognising some of the practical difficulties currently encountered by market participants in complying with Article 55, the BRRD2 Proposals include the amendment of Article 55 of the BRRD to include additional powers permitting resolution authorities to waive the contractual recognition of bail-in requirements in certain circumstances. A waiver can be granted if (i) a resolution authority determines that it would not impede the resolvability of the relevant entity, (ii) it is legally, contractually or economically impracticable to include a contractual recognition clause in certain liabilities, and (iii) the relevant liability can be subject to bail-in by the resolution authority of a member state pursuant to the law of the third country or to a binding agreement concluded with that third country.[133] There are also two new additional moratorium tools to suspend payment and delivery obligations: (i) a new early intervention power (to apply in the pre-resolution phase –see amendment to Article 27 and new Article 29a); the power can be used when it is necessary to assess whether early intervention measures are necessary or to determine whether the institution is failing or is likely to fail and the duration of the stay cannot exceed 5 working days, and (ii) a new general resolution power (to apply in the resolution phase – see amendment to Article 63); the power can be used to suspend payment or delivery obligations when this is needed for the effective application of one or more resolution tools or for the purposes of valuation under Article 36 of the BRRD and, again, the duration of the stay cannot exceed 5 working days.

133 We note that in the current drafting of the revised Article 55, the conditions to a waiver are set out as cumulative, not as alternatives. A cumulative application may not be the intention of the Commission and, if this is a drafting error, it may be capable of correction through the EU legislative process.

~~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).[117] 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.~~

Other relevant 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~~The Recast EU Insolvency Regulation will govern insolvency proceedings ~~from~~commenced on and after 26 June 2017 in place of the existing EC Insolvency Regulation. (The existing EC Insolvency Regulation will continue to apply to insolvency proceedings commenced prior to 26 June 2017.) The key changes in the Recast EU Insolvency Regulation include (i) slightly amended definitions of centre of main interests and establishment (largely to reflect previous case law findings on these two concepts but also bolstered to prevent abusive forum shopping), (ii) an expanded scope to cover certain pre-insolvency procedures and remove the restriction on secondary proceedings to winding up proceedings, (iii) the introduction of a new group coordination proceeding and (iv) a new concept of synthetic secondary proceedings. We also note that the Recast EU Insolvency Regulation makes no substantial changes to the choice of law exceptions in the EC Insolvency Regulation (although the definition for where assets are located has been amended). Accordingly, the Recast EU Insolvency Regulation should not affect the conclusions reached in this memorandum.

~~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~~

~~117 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.~~

~~1 October 2016. The published draft 2016 Insolvency Rules include mutual insolvency set-off provisions.~~

In addition, in November 2016, the Commission published a proposal for a directive on preventative restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU.[134] The proposed directive seeks to introduce minimum standards for pre-insolvency restructuring proceedings. In summary, the areas covered are (i) the introduction of stays on creditor action and the adoption of restructuring plans (including provisions for the cram-down of an impaired class) (articles 5-15); (ii) safe-harbours for new financing and other restructuring related transactions (articles 16-17); (iii) protections for directors who propose a plan (article 18); (iv) limitations on the discharge period for individual debtors (articles 19-23); and (v) certain measures intended to increase the efficiency of restructuring and insolvency proceedings (articles 24-29). It is expected to take at least 12 months before the proposed directive becomes final but certain member states (such as the UK) are already considering similar changes to their restructuring laws to try to attract more restructurings to a particular jurisdiction. As described at part I.5 of this memorandum, we also await further clarification regarding consequential changes to legislation referencing or applying (with or without modification) the Insolvency Rules 1986 or containing analogous provisions following the introduction of the Insolvency (England and Wales) Rules 2016.

We note for completeness, although such entities would be excluded from a future memorandum of this type, that the provisions of the Financial Services (Banking Reform) Act 2013 relating to the special administration regime to apply to certain financial market infrastructure companies operating payment and/or security settlement systems (but excluding recognised central counterparties) known as 'FMI administration' are due to come into force from a date to be appointed. A HM Treasury consultation on the related rules closed in January 2017.

A number of proposals for the reform of Limited Partnerships have previously been advanced. Most recently, prompted by media reports alleging some limited partnerships registered in Scotland are being used as vehicles for a number of different forms of criminality, the Department for Business, Energy and Industrial Strategy (BEIS) published a Call for Evidence on 16 January 2017 seeking views and evidence on the possible reasons why registration of limited partnerships in Scotland (and to a lesser extent in England and Northern Ireland) has increased significantly and the types of economic uses they are put to. The consultation also aims to look more broadly at the reform of the law of limited partnerships, including, transparency requirements, principal place of business for the purposes of registration, the serving of legal documents and the arrangements for the ending of a limited partnership. This consultation closed on 17 March 2017.

Finally, consideration should be given to the implications of 'Brexit'. On 23 June 2016 in a referendum on the UK's continued participation in the European Union, a majority of those voting voted to leave the European Union. The first step in the formal process to do so, which is the giving of notice by the UK to the European Council of its intention to withdraw under Article 50 of the Treaty on European Union, was taken on 29 March 2017 following the earlier adoption of the European Union (Notification of Withdrawal) Act 2017. The UK will cease to be a member of the EU no later than two years following that, unless the UK requests and the 27 other member states unanimously agree to an extension.

In relation to the transposition of the BRRD, for example, upon leaving the European Union, the Banking Act would, absent any specific decision to change the position, likely remain in place in its current form. Amendments already made to existing legislation should not be affected. However, the position in respect of the status of (i) stand-alone secondary legislation enacted pursuant to the

134 COM(2016)723 final.

European Communities Act 1972, and (ii) any EC delegated and implementing regulations relating to the BRRD that apply directly in the UK, would need to be clarified. Any references to EU authorities, member states and cross-references to definitions in other EU law etc. that have been transposed into UK law from the BRRD may also need to be amended. The question of mutual recognition of resolution action (and recognition of insolvency proceedings under the EC Insolvency Regulation (as to which see the developments described above)) will also be key. Whilst the UK could unilaterally legislate for the UK recognition, there would be no guarantee of reciprocity from the EU.

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This memorandum of law is addressed to ISDA solely for its benefit and the benefit of its members in relation to their use of the ISDA Master Agreement. 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 or by ISDA to a competent regulatory or supervisory authority or professional advisors for such ISDA member or ISDA (respectively) 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
~~30 December 2015~~23 June 2017

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 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.[~~118~~135]

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

~~118~~135 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.

borrower's obligation to replace the securities at a defined date with identical securities.[~~119~~136]

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.

[~~119~~136] 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 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~~120~~137

Description	Covered~~121~~138	Legal form(s)~~122~~139
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 Community (**EC**) 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~~123~~140
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	Yes, but only in relation to the Central Bank of the United	Chartered Corporation

~~120~~137 In these definitions, the term "legal entity" means an entity with legal personality other than a private individual.

~~121~~138 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.

~~122~~139 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 be 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.

~~123~~140 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~~[121]~~[138]	Legal form(s)~~[122]~~[139]
European Central Bank in respect of the euro zone).	Kingdom	
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 and English Partnership
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, additional analysis required	
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 EC legislation.	Yes	English Company

Description	Covered~~[121]~~[138]	Legal form(s)~~[122]~~[139]
Investment Fund. A legal entity or an arrangement without legal personality (for example, a common 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 EC 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.	Yes	Open-Ended Investment Company, Authorised Unit Trust (acting through its Trustee) and Limited Partnership[141]
Local Authority. 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, additional analysis required	
Partnership. 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~~Yes	English Partnership
Pension Fund. 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	~~No~~Yes	English Pension Fund (acting through its Trustee)

141 See note 18.

Description	Covered~~[121]~~[138]	Legal form(s)~~[122]~~[139]
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 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	
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, additional analysis required	
Sovereign-Owned Entity. A legal entity wholly or	An English	English Company

Description	**Covered**~~[121]~~[138]	**Legal form(s)**~~[122]~~[139]
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").	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.	
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, additional analysis required	
Banking Group Company and Bank Holding Companies	Yes	English Company
Standard Chartered Bank	Yes	Chartered ~~corporation~~Corporation
English Trust	Yes	English Trust (acting through its Trustee(s))

Description	Covered~~[121]~~[138]	Legal form(s)~~[122]~~[139]
English Charity	Yes	English Charitable Trust (acting through its Trustee(s)), English Company, Friendly Society, C/CB Society, Statutory Corporation~~,~~ and 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:[~~124~~][142]

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

(b) a qualifying ~~licensed~~ water ~~supplier~~supply licensee within the meaning of section 23(6) of the Water Industry Act 1991 or a qualifying sewerage licensee within the meaning of section 23(8) of the Water Industry Act 1991;

(c) a licensed infrastructure provider within the meaning of the Water Industry (Specified Infrastructure Projects) (English Undertakers) Regulations 2013;[143]

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

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

(~~e~~f) a public-private partnership company under the Greater London Authority Act 1999.[~~125~~][144]

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. We also do not consider a community interest company under the Companies (Audit, Investigations and Community Enterprise) Act 2004 and the Community Interest Company Regulations 2005 (each as amended) or, with the exception of Annex 16 (in which we consider the Trustee of an Authorised Unit Trust), an English Company that is an institution of a class specified in paragraph (2) of regulation 2 of the Investment Bank (Amendment of Definition) and Special Administration (Amendment) Regulations.[145] More generally we assume that the English Company is not subject to a special regulatory regime not contemplated by this memorandum.

~~124~~142 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.

143 SI 2013/1582. The Water Industry (Specified Infrastructure Projects) (English Undertakers) Regulations 2013 apply the special insolvency regime applicable to the entities listed at (a) and (b) above (subject to certain modifications) to such entities.

~~125~~144 Section 249 of the Enterprise Act 2002 also refers to English Building Societies, which are covered by this memorandum, as noted above.

145 SI 2017/443.

APPENDIX D

ARTICLES 23 AND 25 OF THE WINDING UP DIRECTIVE

As mentioned in part IV, the Winding Up Directive (which is implemented in England through the Winding Up Regulations) creates a ~~cross border~~cross-border framework that applies to the reorganisation and winding up of EEA credit institutions and EEA investment firms. It also applies to certain EEA group companies to the extent that one or more of the resolution tools or resolution powers provided for in the BRRD have been applied in respect of the relevant group company. It also includes some limited provisions relating to non-EEA credit institutions and investment firms.

The basic rule is that the law of the home state of an EEA credit institution or investment firm governs its insolvency and resolution proceedings but there are certain derogations including Article 23 (Set-off) and Article 25 (Netting agreements).

Article 23(1) provides as follows:

> "The adoption of reorganisation measures or the opening of winding-up proceedings shall not affect the right of creditors to demand the set-off of their claims against the claims of the credit institution, where such a set-off is permitted by the law applicable to the credit institution's claim."

Article 25 provides as follows:

> "Without prejudice to Articles 68 and 71 of Directive 2014/59/EU [the BRRD], netting agreements shall be governed solely by the law of the contract which governs such agreements."~~[126]~~[146]

Application of Articles 23 and 25

The Winding Up Regulations include these derogations~~[127]~~[147], with somewhat different wording (particularly in the case of regulation 34 which implements Article 25 as discussed below), but also without elaboration. While there is no definition of "netting agreement" in the Winding Up Directive or in the Winding Up Regulations, we believe that the ISDA Master Agreement would be a netting agreement for these purposes and therefore benefit from the derogation in Article 25.~~[128]~~[148]

In relation to an ISDA Master Agreement entered into between a solvent party and a credit institution or investment firm subject to insolvency proceedings in an EEA member state other than the United Kingdom, the application of Article 25 and the local implementation of it are most likely to be considered before the courts of that EEA member state.

~~126~~146 Article 26 contains a similar derogation in respect of "repurchase agreements".

~~127~~147 See Regulation 28 and 34 of the Winding Up Regulations

~~128~~148 The question arises whether, if only one Transaction is entered into under an ISDA Master Agreement, such ISDA Master Agreement would still be capable of constituting a "netting agreement". This is arguable but we consider the better view is that such agreement may still be capable of constituting a netting agreement. The question goes to the policy intention behind the provision and, where the sole Transaction is categorised as an executory contract, arguably the policy objective remains as the relevant Transaction has not yet been converted into a net sum. In any event, regulation 34 appears to protect the agreement as a whole not just the operation of the close-out netting provisions. Regulation 36, which clearly protects repurchase agreements as a whole, would seem to add weight to this view.

Subject to the above, if the ISDA Master Agreement is governed by English law, then under the Winding Up Directive English law should govern the enforceability of the netting provisions (but without prejudice to Articles 68 and 71 of the BRRD).

Unfortunately the application of Article 25 is uncertain in a number of respects. Firstly, it is not clear whether the reference to the 'the law of the contract' includes the provisions of insolvency or resolution law.

Taking the example of an English law governed ISDA Master Agreement and an EEA credit institution, it is not possible under the Winding Up Directive for there to be insolvency or resolution proceedings in England in respect of that EEA credit institution. Accordingly, there is an argument that English insolvency or resolution law would not apply to the question of the enforceability of such an ISDA Master Agreement, which would be determined instead in accordance with otherwise applicable principles of English law, principally English contract law. If this interpretation is correct, then our discussion in part V would be relevant in respect of an English law governed ISDA Master Agreement.

However, it appears to be the prevailing view at least in England that when applying English law, a hypothetical insolvency~~[129]~~[149] under the closest equivalent proceedings in England should be assumed. Contractual law is more permissive, for example of set-off, than insolvency law in certain jurisdictions and therefore referring to a hypothetical insolvency when applying Article 23 and 25 allows for a more direct comparison of the treatment of set-off or netting including under insolvency law.

A further question arises as to what hypothetical insolvency should be assumed. Using the example above of an EEA credit institution and an English law governed ISDA Master Agreement, there is a risk that English law would import the relevant insolvency law of the home state of the EEA credit institution under regulation 5 of the Winding Up Regulations. However, this approach would deprive Article 25 of its substance. Therefore, in our view, the hypothetical insolvency (or resolution) that is considered should be based on the proceedings available in respect of a similar type of entity incorporated in England and without reference to the insolvency or resolution law of the relevant other member state imported into English law under regulation 5 of the Winding Up Regulations~~[130]~~[150].

Article 23, unlike Article 25, is clear that it is intended to protect the right of set-off in circumstances where the relevant reorganisation measure or the opening of winding up proceedings would affect the right to set-off but set-off is permitted under 'the law applicable to the credit institution's claim'. In other words, if the right of set-off is permitted in the insolvency or resolution proceedings in respect of the EEA credit institution, there is no need to rely on Article 23. However, if set-off is prohibited under the insolvency or resolution proceedings, but not under the law applicable to the claim, set-off is still permitted. Article 25 is less clear – it simply says the netting agreements will be governed by the law of the contract which governs such agreement. However, in our opinion, the better view is that a similar approach should be adopted to Article 25. The first question to consider is the purported effect of the relevant resolution or insolvency measures that have been implemented in the jurisdiction of the EEA credit institution. The relevant action or effect should then be compared to what would be possible under the law governing the contract in the relevant hypothetical insolvency or resolution. To the extent that the relevant action or effect, for example overriding netting, is not possible under the law governing the contract, Article 25 should act as a protective measure (in the same way as Article 23).

~~129~~149 We are not aware of any academic commentary or case law to date which considers whether a hypothetical resolution should also be considered if the EEA bank in question is being resolved rather than being placed into insolvency proceedings but this would be the logical extension of the hypothetical insolvency approach.

~~130~~150 This approach is not without its problems. It may be difficult to determine the closest analogous proceedings in any particular case. Furthermore, the availability of set-off in any particular case may depend on certain fact-specific conditions and it may be difficult to determine whether these would apply in the hypothetical proceedings.

However, given the difference in drafting highlighted above, this interpretation is not certain. An alternative interpretation of Article 25 would be to import the governing law in its entirety and argue that the effect of Article 25 is not solely protective in nature – in other words, even where it is not possible to take an action in the resolution or insolvency proceedings that apply in respect of the insolvent credit institution to undermine a netting agreement, if this is possible under the law governing the contract, then the court or insolvency official in the jurisdiction of the resolution or insolvency proceedings can take that action. This interpretation is based on the fact that Article 25 simply refers to the netting agreement being governed solely by the law of the contract – clearly this would potentially have dramatic consequences and, in our view, if this approach was intended Article 25 would have been drafted to state this more expressly, particularly following the introduction of the BRRD.

As noted above, the Winding Up Regulations use slightly different words to the Winding Up Directive. Regulation 34 (Netting agreements) provides that the effect of a relevant reorganisation or a relevant winding up on a netting agreement shall be determined in accordance with the law applicable to that agreement. In our view, the drafting of regulation 34 supports our interpretation of Article 25 that the only available measures are those of the jurisdiction of the reorganisation or winding up but the effectiveness of such measures on a netting agreement is determined by a comparison with whether equivalent measures would be possible in an analogous hypothetical insolvency under the law applicable to the netting agreement.

Finally, it is worth noting that Article 30 (Detrimental Acts) of the Winding Up Directive operates in a different way to Articles 23 and 25. Where the applicable law of an act detrimental to the creditors as a whole does not allow any means of challenging the act in question, this must be raised as a defence in any avoidance challenge brought in the place of the resolution or insolvency proceedings. In other words, it is clear from the wording of Article 30 that there is no need to look beyond the law of the resolution or insolvency proceedings if there is no means of challenging the act in question. Furthermore the reference to "any means of challenge" makes it clear that it is not just the contractual law of the applicable law that is to be considered but also the insolvency (and by analogy resolution) law of the applicable law. This is an argument against considering a hypothetical insolvency or resolution for the purposes of Article 23 and 25 where similar language is not used.

Assuming that the hypothetical insolvency approach is correct, in respect of an English law governed ISDA Master Agreement parts III, IV and V and the relevant Annexes (including the analysis of the Banking Act in those Annexes) would be relevant to the consideration of what would occur under the hypothetical insolvency.

Note that any net amount due under Section 6(e) of the ISDA Master Agreement eligible for inclusion in a contractual set-off provision set out, for example, in Part 5 of the Schedule to a 1992 Agreement or in Section 6(f) of the 2002 Agreement would benefit from the derogation in Article 23 of the Winding Up Directive.

Ultimately, in respect of an English Bank or other English entity within the scope of the Winding Up Directive, these issues are only likely to arise in the context of a New York law governed ISDA Master Agreement (discussed below). As already noted above, in respect of an English law governed ISDA Master Agreement, Article 25 would be engaged in respect of an EEA credit institution and these issues would therefore most likely be decided in that forum.

Application to New York law governed ISDA Master Agreements

We note that neither Article 23 nor Article 25 of the Winding Up Directive (nor regulations 28 or 34 of the Winding Up Regulations) is expressly limited in its scope of application to the law of an EEA member state (compare, for example, with Article 24 of the Winding Up Directive where the draftsman has expressly referred to the law of the relevant EEA state). In addition, given it is not uncommon for agreements to be governed by the laws of a non-EEA ~~Member State~~member state, it would limit the practical utility of these provisions if they were limited to the laws of EEA ~~Member States~~member states only.

Accordingly, an ISDA Master Agreement subject to New York law should be eligible for the benefit of Article 25, and a contractual set-off clause in an ISDA Master Agreement subject to New York law should be eligible for the benefit of Article 23. We note that there is a minority view (at least in England) to the contrary – the arguments in favour of that view include:

(a) The Virgos-Schmit Report on the Convention on Insolvency Proceedings (what became the EC Insolvency Regulation[~~131~~151] which contains similar choice of law rules, in the case of non-financial institution corporate insolvency proceedings, to those set out in the Winding Up Directive) refers in paragraph 93 to the exceptions to the general choice of law rule in the EC Insolvency Regulation. The Virgos-Schmit Report notes that most of the exceptions except for Article 6 (set-off) and Article 14 (protection of third party purchasers) refer to the law of a ~~Member State~~member state and therefore Articles 6 and 14 should be interpreted in the same way "by systemic arguments". An analogous argument could be made in respect of the exceptions to the general choice of law rule in the Winding Up Directive.

(b) Recitals (23) and (24) of the Winding Up Directive refer to the law of another ~~Member State~~member state when referring to the exceptions to the general choice of law rule under the Directive and, in the UK, the Part of the Winding Up Regulations in which regulation 28 and 34 are to be found is titled "Reorganisation or Winding Up of UK Credit Institutions: Recognition of EEA Rights".

(c) Given that resolution proceedings across the EEA should (at least in theory) be broadly similar as a result of the implementation by ~~Member States~~member states of the BRRD (at least once the BRRD is incorporated into the EEA Agreement), by limiting the exceptions to the general choice of law rule under the Winding Up Directive to the laws of EEA ~~Member States~~member states, the application of Article 25 to resolution measures should be more straightforward.

Notwithstanding these arguments, we consider that the better view is that the choice of law rules should not be limited to the applicable laws of EEA ~~Member States~~member states. However, as noted above, unless the relevant insolvent entity is an English Bank or other English entity within the scope of the Winding Up Directive, this issue is unlikely to be determined by an English court.

Interaction with the BRRD

The netting safeguard in Article 25 was amended to ensure that it does not affect the application of the stays on termination provided for in Articles 68 and 71 of the BRRD. However, as noted above,

~~131~~151 Council Regulation (EC) 1346/2000. The relevant provisions of Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast) (Recast Insolvency Regulation) use the same formulations (see Article 9 (set-off) and Article 17 (protection of third party purchasers)).

Article 25 does apply to resolution proceedings more generally (such as the making of special bail-in provision in respect of the liabilities of an English Bank under a New York law governed ISDA Master Agreement).

As with Article 25 more generally, its application in such circumstances is ~~generally~~decidedly unclear. However, in our view a similar approach should be taken to insolvency and resolution proceedings as outlined above (including as to it being protective in nature rather than expanding the scope of available powers/procedures). This approach is not without difficulties, especially where the law governing the contract is ~~non EEA~~non-EEA.

In particular:

(a) How would one determine the closest analogous proceedings, particularly if under the relevant non-EEA law there is no similar resolution tool (such as a partial property transfer ~~tool~~power or bail-in tool) as there would be under the Banking Act or the BRRD?

(b) What if the non-EEA law was capable of affecting the ISDA Master Agreement but only if certain conditions were satisfied or only to a certain extent? We consider that a distinction needs to be drawn here between procedural and substantive provisions of the non-EEA law. If there are any substantive constraints on the ability of the non-EEA law to affect the ISDA Master Agreement, these would need to be taken into account in the analysis under Article 25 (and regulation 34). However, if the constraints were merely procedural ones, these could be ignored as the law of the relevant state where the reorganisation, winding up or resolution proceedings are actually commenced will determine any procedural requirements that need to be complied with.

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~~[132]~~ ~~[133]~~[152] [153] against ~~a trust~~an English 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.~~[134]~~[154]

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:

(a) 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;

(b) 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;

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

(d) 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,

~~132~~ ~~Section 31(1) Trustee Act 2000. Also see *Jennings v Mather* [1902] 1 KB1 .~~

~~133~~ ~~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 E~~

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

153 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 E.

~~134~~154 In this Appendix E 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).

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 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.[~~135~~155] 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 English 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.[~~136~~156]

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 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. 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~~Ex parte Garland*[~~137~~157] and *Fairland v Percy*[~~138~~158] 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

~~135~~155 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 ~~30 December 2015~~14 May 2017).

~~136~~156 *Devaynes v Robinson* (1857) 24 Beav 86.

~~137~~157 (1804) 10 Ves 110.

~~138~~158 (1875) LR 3 P&D 217.

the Trustee's own lien. We note that the Trust Law Committee was firmly of this view in the 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.

(c) In order to avoid the problems associated with a creditor merely being subrogated to the Trustee's right of reimbursement from the trust fund, with the problems this raises (as discussed above), the Trust Law Committee recommended, in the 1999 Report, that the creditor should seek security over particular trust assets. The trust deed would need to authorise the Trustee to grant such security. The other party to the ISDA Master Agreement may wish to consider this option as it would ensure that it had a right of recourse to the assets of the English Trust over which the security was taken. However, we would expect that commercially this could be difficult to achieve and the Trustee is unlikely to agree. Another alternative referred to by the Trust Law Committee would be for the creditor to become a beneficiary of the trust but, again, this seems very unlikely.

ANNEX 1

ENGLISH BANK

In this Annex 1, we set out our views regarding the enforceability of the close-out netting provisions of the ISDA Master Agreement 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 this memorandum;

(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~~[139]~~[159] (**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~~[140]~~[160]. 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 this memorandum;

(b) the Bank Administration Procedure;

(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**).

~~139~~159 SI 2011/245.

~~140~~160 "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).

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.

1. Conclusions

1.1 On the basis of the assumptions and subject to the qualifications in part III of this memorandum as modified and supplemented by this Annex 1, we are of the view that our conclusions in part III.3 would also apply to an English Bank.

1.2 Subject to the analysis in this Annex 1, in the event that an English Bank were made subject to the Bank Insolvency Procedure, the Bank Administration Procedure, Special Administration (Bank Insolvency), Special Administration (Bank Administration) or Investment Bank Special Administration or became subject to a transfer scheme under Part VII of the Financial Services and Markets Act 2000 or to the special resolution regime under Part 1 of the Banking Act, we are of the view that the close-out netting provisions of the ISDA Master Agreement would be enforceable against the English Bank.

2. Analysis

2.1 *Winding Up Regulations*

We discuss below the position under English law. However, special rules apply to the ~~cross border~~cross-border aspects of the insolvency of an English Bank. These are primarily set out in the Winding Up Regulations, which are discussed in part IV of this memorandum and Appendix D.

In particular, as discussed in Appendix D, under regulation 34 of the Winding Up Regulations the effect of a relevant reorganisation or relevant winding up on a netting agreement shall be determined in accordance with the law applicable to that agreement (subject to a carve out which ensures that the suspension of termination rights under the Banking Act or equivalent implementing legislation of any other EEA State is effective). The definitions of 'relevant reorganisation' and 'relevant winding up' in the Winding Up Regulations include an administration, CVA or winding up under the Insolvency Act 1986, the Bank Insolvency Procedure~~[141]~~[161], the Bank Administration Procedure~~[142]~~[162], Special Administration (Bank Insolvency)~~[143]~~[163], Special Administration (Bank Administration)~~[144]~~[164] and Investment Bank Special Administration~~[145]~~[165]. The terms do not extend to a scheme of arrangement under the Companies Act 2006 or administrative receivership. However, the definitions do cover the making of a stabilisation instrument in respect of the English Bank. A "stabilisation instrument" includes the various resolution instruments that can be made under Part 1 of the Banking Act in respect of an English Bank.

Assuming regulation 34 applies to the relevant proceeding (or action), the enforceability of a New York law ISDA Master Agreement may primarily be a matter of New York law. However, as discussed in Appendix D in more detail, we are aware that there is a minority

~~141~~161 The Bank Insolvency Procedure is triggered by a court making a winding-up order and see also the Banking Act 2009 (Parts 2 and 3 Consequential Amendments) Order 2009 (SI 2009/317), article 3.

~~142~~162 See the Banking Act 2009 (Parts 2 and 3 Consequential Amendments) Order 2009 (SI 2009/317), article 3.

~~143~~163 See the Investment Bank Special Administration Regulations 2011, Schedule 1, paragraph 3

~~144~~164 See the Investment Bank Special Administration Regulations 2011, Schedule 2, paragraphs 4 and 5.

~~145~~165 See the Investment Bank Special Administration Regulations 2011, Schedule 6.

view (at least in England) that regulation 34 would not apply to a New York law governed ISDA Master Agreement as it is not an EEA law. In addition, as discussed in more detail in Appendix D, a number of aspects of the Winding Up Regulations are subject to uncertainty. See part IV and Appendix D for ~~a~~ further discussion in relation to the cross-border aspects of the insolvency (or resolution) of an English Bank.

Note also in this context that Article 55[166] of the BRRD, as implemented into English law through rules published by the PRA[167] and FCA[168], requires in-scope entities to include a contractual term in agreements governing any relevant liability (i.e. not an "excluded liability" for bail-in or other excluded deposit and governed by a third country (i.e. non-EEA) law), which are created or materially amended after certain dates, whereby the creditor or party to the agreement creating the liability recognises the effect of bail-in under the Banking Act and agrees to be bound by it.[169]

Similarly, the PRA has made rules[170], requiring PRA-authorised banks, building societies and PRA-designated investment firms as well as qualifying parent undertakings to agree in an enforceable manner with counterparties (except excluded counterparties) to "financial arrangements"[171] governed by a third country (i.e. non-EEA) law whenever an obligation is created or materially amended that their termination rights under, or rights to enforce a security interest in connection with, the financial arrangement will be stayed to the same extent they would be if the arrangement were governed by the laws of any part of the UK in the event of resolution action under the SRR in respect of such party or a member of its group.[172] The rules also oblige such firms to ensure that their subsidiaries that are credit institutions, investment firms (or undertakings which would be investment firms if they had their head office in the EEA) 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.

2.2 *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**)

166 See also Commission Delegated Regulation (EU) 2016/1075 of 23 March 2016 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the content of recovery plans, resolution plans and group resolution plans, the minimum criteria that the competent authority is to assess as regards recovery plans and group recovery plans, the conditions for group financial support, the requirements for independent valuers, the contractual recognition of write-down and conversion powers, the procedures and contents of notification requirements and of notice of suspension and the operational functioning of the resolution colleges (the **Article 55 RTS**). The Article 55 RTS provides further detail as to the list of liabilities excluded and the contents of the term required under Article 55 of the BRRD.

167 Contained in PRA Rulebook Part entitled "Contractual Recognition of Bail-In". See PRA Rulebook: CRR Firms and Non-Authorised Persons: Contractual Recognition of Bail-In Instrument 2015 (PRA 2015/5) and PRA Policy Statement 1/15.

168 Contained in the FCA Handbook in the Prudential sourcebook for Investment Firms (IFPRU), chapter 11.6. See FCA Recovery and Resolution Directive Instrument 2015 (FCA 2015/1) and FCA Policy Statement 15/2.

169 The PRA's rules were amended with effect from 1 August 2016 to allow for non-compliance in respect of certain liabilities (being an "unsecured liability that is not a debt instrument") where compliance would be "impracticable". Prior to that date, a 'modification by consent' had been available. On 30 December 2015, the FCA published a 'modification by consent' which aims to replicate the approach adopted by the PRA.

170 Contained in PRA Rulebook Part entitled "Stay In Resolution" (the **PRA Stay Rules**). See PRA Rulebook: CRR Firms and Non-Authorised Persons: Stay In Resolution Instrument 2015 (PRA 2015/82) and PRA Policy Statement 25/15.

171 "Financial arrangement" means (i) financial contracts as defined in point 100(a) to (d) of Article 2(1) of BRRD, (ii) a derivative as defined in Article 2(5) of EMIR and (iii) a master agreement in so far as it relates to items (i) and (ii) or a contract for the sale, purchase or delivery of the currency of the UK or any other country, territory or monetary union.

172 The PRA Stay Rules have applied from (i) 1 June 2016 for financial arrangements where one counterparty is a credit institution or investment firm (each as defined in the Capital Requirements Regulation) or an undertaking that would be an investment firm if it had its head office in the EEA, and (ii) 1 January 2017 for financial arrangements with all other counterparties.

have certain powers to initiate and to intervene in insolvency proceedings in relation to English Banks.[~~146~~173] 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 part III.3 of this memorandum as they would apply to an English Bank.

Accordingly, and subject to these qualifications, our conclusions and analysis in part III.3 of this memorandum also apply in relation to an English Bank.

2.3 *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.[~~147~~174]

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.[~~148~~175] 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,[~~149~~176] but if it is, an application is made to the court for an 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 override the right of a party to an ISDA Master Agreement with an English Bank to designate an Early Termination Date as the result of an Event of Default or Termination Event under the ISDA Master Agreement that occurs as a result of something done or likely to be done in connection with a banking business transfer scheme.

~~146~~173 For example see Part XXIV of the Financial Services and Markets Act 2000 and section 120 of the Banking Act.

~~147~~174 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.

~~148~~175 Section 106 of the Financial Services and Markets Act 2000.

~~149~~176 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.

Note that an order can only be made if the court considers that, in all the circumstances, it is appropriate to sanction the scheme. We do not believe, however, that an English court would make an order that would permit some but not all of the rights and liabilities under an ISDA Master Agreement to be transferred under a transfer scheme, and therefore we do not believe that an order would be made that is inconsistent with our material conclusions in relation to the enforceability of close-out netting under the ISDA Master Agreement.

There may, however, be certain circumstances in which a party is prevented from designating an Early Termination Date in respect of an English Bank where it might otherwise have had the right to do so. Any such order would, in our view, be limited to the carrying out of the scheme and would involve the transfer of the whole of the ISDA Master Agreement (including all rights and obligations under the ISDA Master Agreement, each Transaction and any related Credit Support Document) to the transferee or would leave the ISDA Master Agreement with the original English Bank.

We do not believe that an English court would have the power under Part VII of the Financial Services and Markets Act 2000 to make an order that would prejudice the right of a party to designate an Early Termination Date under the ISDA Master Agreement as a result of an Event of Default or Termination Event in respect of the English Bank occurring independently of, and after completion of, the transfer under Part VII.

2.4 *Banking Act*

Our conclusions in part III.3 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.[~~150~~177]

(a) Key elements of the Banking Act

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. [~~151~~178]

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

[~~150~~177] Building societies and credit unions also fall within the scope of the Banking Act. 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). 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.

[~~151~~178] 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).[~~152~~179]

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[~~153~~180] (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~~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[~~154~~181] 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~~member states with the relevant resolution tools and powers to restructure failing institutions within its scope. Individual ~~Member States~~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[~~155~~182].

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[~~156~~183] (the **BRR Order 2014**), which came into force on 1 January 2015. More recently, the BRR Order 2016 makes a number of further changes to the Banking Act regime.

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

~~152~~179 Section 1(2) of the Banking Act.

~~153~~180 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.

~~154~~181 Article 130(1) of the BRRD allows for ~~Member States~~member states to apply provisions relating to the 'bail-in tool' from 1 January 2016 at the latest.

~~155~~182 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.

~~156~~183 SI 2014/3329.

failing English Bank have been met.~~[157]~~[184] 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 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 of the Banking Act or otherwise).~~[158]~~[185] 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~~2017 (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 is composed of 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 the ISDA Master Agreement 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

~~157~~184 Section 7 of the Banking Act.

~~158~~185 In relation to the special resolution objectives, see section 4 of the Banking Act.

Bank of England;~~[159]~~[186] (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 write-down; and (v) temporary public ownership (nationalisation) of all or part of the relevant entity.~~[160]~~[187]

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.~~[161]~~[188]

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)~~[162]~~[189] 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".~~[163]~~[190] 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 would not affect the rights or obligations of the parties to the ISDA Master Agreement, 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"~~[164]~~[191] or a "property

~~159~~186 This tool can only be used in conjunction with one of the other stabilisation tools: section 8ZA(2) of the Banking Act.

~~160~~187 Section 1(3) of the Banking Act.

~~161~~188 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.

~~162~~189 Section 14 of the Banking Act.

~~163~~190 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.

~~164~~191 Section 33(1) of the Banking Act.

transfer order"[~~165~~192]. 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 transfer of some, but not all, of the property, rights or liabilities of an English Bank.[~~166~~193] 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,[~~167~~194] 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.[~~168~~195]

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 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 ISDA Master Agreement and each Transaction, as a matter of English law would be unaffected.

(iii) *Application of the partial property transfer power to an English Bank*

In relation to a partial property transfer, the concern is that the Authorities could use such power to "cherry-pick" Transactions (or parts of such Transactions) covered by the ISDA Master Agreement or otherwise disrupt the mutuality of rights and obligations under that arrangement. Accordingly, the Banking Act 2009 (Restriction of Partial Property Transfers) Order 2009[~~169~~196] (as amended[~~170~~197], the **Partial Property Safeguards Order**) provides various protections from the effect of partial property transfers. 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,

~~165~~192 Section 45 of the Banking Act which applies to the temporary public ownership stabilisation option.

~~166~~193 Section 33(2) of the Banking Act.

~~167~~194 Section 39(3) of the Banking Act.

~~168~~195 Section 39(4) of the Banking Act.

~~169~~196 SI 2009/322.

~~170~~197 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), the BRR Order 2014 and the BRR Order 2016.

of the "protected rights and liabilities" between an English Bank and a particular person under a "netting arrangement" or a "set-off" arrangement". In our view:

(A) an ISDA Master Agreement would be a "netting arrangement" or a "set-off" arrangement as defined in section 48(1) of the Banking Act~~[171]~~[198]; and

(B) all rights and obligations under an ISDA Master Agreement, including in relation to Transactions falling within the scope of Appendix A, between an English Bank and a party would be "protected rights and liabilities" (except to the extent such rights or obligations relate to an indemnity under the ISDA Master Agreement~~[172]~~[199]) within the scope of the Partial Property Safeguards Order ~~[173]~~ if they are subject to set-off or netting under the ISDA Master Agreement~~; and~~.

However, in this context, we note the Commission Delegated Regulation under Article 76 of the BRRD[200] (the **Partial Property Transfer Delegated Act**). By way of background, Articles 76(1) and (2) of the BRRD provide that member states shall ensure appropriate protection for certain arrangements, including set-off and netting arrangements, in the event of a partial property transfer. Article 76(4), however, then states that the Commission shall adopt delegated acts further specifying the classes of arrangement that fall within the scope of Article 76(2) and are consequently protected in the context of a partial property transfer. The Partial Property Transfer Delegated Act was published in the Official Journal on 20 May 2017 and entered into force 20 days later on 9 June 2017. In the context of netting and set-off arrangements, the Partial Property Transfer Delegated Act states that such arrangements, where entered into between the relevant institution and a single counterparty, qualify as netting and set-off arrangements for the purposes of Article 76(2) of the BRRD where they relate to assets and liabilities arising under "derivatives" and "financial contracts".[201] The Partial Property Transfer Delegated Act reserves to resolution authorities the discretion to protect such arrangements

~~171~~198 While an ISDA Master Agreement with one Transaction may be capable of satisfying these definitions, rights and liabilities are only protected for the purposes of the Partial Property Safeguards Order if a party is entitled to set-off or net them under that arrangement. In our view, where the Transaction is an executory contract, this requirement is likely satisfied. However, if the Transaction is categorised as a contingent obligation to pay a debt (for example, fully-paid options) this would not be the case (assuming all other obligations in respect of the Transaction have been performed) although, in these circumstances, we note that the close-out netting provisions would not, in any event, be deprived of their substance by a partial property transfer.

~~172~~199 Such rights and liabilities are "excluded rights" or "excluded liabilities" (as applicable) under the Partial Property Safeguards Order. We also assume for completeness that the other party to the ISDA Master Agreement with the English Bank is not an eligible claimant (as defined in the Partial Property Safeguards Order).

~~173 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 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.~~

200 Commission Delegated Regulation (EU) 2017/867 of 7 February 2017 on classes of arrangements to be protected in a partial property transfer under Article 76 of Directive 2014/59/EU of the European Parliament and of the Council.

201 Articles 3(1) and 4(1).

relating to other types of rights and liabilities on a case-by-case basis where certain conditions are met (this is discussed further below).[202]

Our view is that the current formulation of the protection under English law for set-off and netting arrangements, embodied in the Partial Property Safeguards Order, should now be read as limited by reference to the Partial Property Transfer Delegated Act. The interaction between the two, however, is uncertain. As described above, the Partial Property Delegated Act simply seeks to define the arrangements to be protected as mandated by Article 76 of the BRRD. Moreover, the proper interpretation of the Partial Property Transfer Delegated Act is far from clear. Article 4 (concerning netting arrangements) could *prima facie* be read in the following three ways: (i) contractual netting agreements[203] should be protected in full where they relate in part to derivatives or financial contracts, (ii) contractual netting agreements should be protected *to the extent* they relate to derivatives and financial contracts, or (iii) contractual netting agreements should be protected only where they relate wholly to derivatives and financial contracts (the so-called 'one bad apple spoils the whole barrel' risk).

While it seems likely from the recitals to the Partial Property Transfer Delegated Act that the interpretation described at (i) above is not intended, as the recitals discuss the need to restrict categories of protected arrangement in order to ensure the efficacy of the partial property transfer tool, it is not clear whether the intended approach is accurately summarised by (ii) or (iii) above. We see no reason why option (iii) should prevail and consider this unlikely; there seems no logic in excluding certain arrangements relating to derivatives and financial contracts from the scope of protection entirely merely because certain assets and liabilities may relate to transactions falling outside the confines of those terms, while protecting other arrangements that relate wholly to the prescribed transactions. Clearer wording would surely be required if this were the intention. However, the possibility cannot be entirely excluded.

The situation following the introduction of the Partial Property Transfer Delegated Act is therefore far from satisfactory. In particular, the interaction with the Partial Property Safeguards Order needs to be reconciled and we expect that the Partial Property Safeguards Order will be amended to reflect the requirements of the Partial Property Transfer Delegated Act. Although the manner in which the Partial Property Safeguards Order is amended should, in turn, provide some clarity regarding the proper interpretation of the Partial Property Transfer Delegated Act, ultimately it is the latter that would prevail and not the interpretation of a single member state.

202 Article 5(2) of the Partial Property Transfer Delegated Act states that resolution authorities may exclude from the protection afforded by Article 76(1) of the BRRD set-off and netting arrangements "which relate to contracts including any clause which, in the event of default of a counterparty, permits a non-defaulting counterparty to make limited payments only, or no payments at all, to the estate of the defaulting party, even if the defaulting party is a net creditor." In our view this refers to the ability of a non-defaulting party to withhold termination payments, such as, pursuant to a 1992 Agreement under which First Method is elected (which we have assumed is not the case for the purposes of this memorandum) as opposed to on-going payments under Section 2(a)(i). We note that the language of Article 5(2) is analogous to that used in Article 296 of the Capital Requirements Regulation and our understanding is that market participants take this view in the context of that Regulation.

203 Note that, for the purposes of the Partial Property Transfer Delegated Act, "contractual netting agreement" means a contractual netting agreement as defined in Article 295 of the Capital Requirements Regulation.

Most of the Transactions listed at Appendix A will constitute "derivatives" or "financial contracts" within the meaning of the BRRD[204] and therefore the ISDA Master Agreement would (to the extent it relates to derivatives and financial contracts (subject to the above discussion regarding the proper interpretation of the Partial Property Transfer Delegated Act)) continue to be protected notwithstanding the entry into force of the Partial Property Transfer Delegated Act.[205] It is, however, possible that certain Transactions will not constitute derivatives or financial contracts and therefore will not be safe-harboured. Whether or not this is the case will depend on the specific terms and features of the particular Transaction that is under consideration.

In addition, as mentioned above, the Partial Property Transfer Delegated Act reserves to the resolution authorities of member states the discretion to extend the protection for netting and set-off arrangements beyond the limits of the definitions of derivatives and financial contracts either (i) in individual cases where they are recognised for risk mitigation purposes under applicable prudential rules and protection, in particular by non-separability, is a condition for that recognition[206], or (ii) where they are "protected in normal insolvency proceedings against a temporary or indefinite separation, suspension or cancellation of assets, rights and liabilities falling under these arrangements under their national insolvency law including the national transposition of Directive 2001/24/EC."[207] The scope of this discretion is far from clear but, where the Bank of England does have the discretion to protect the operation of close-out netting under the ISDA Master Agreement, it may well be influenced by policy reasons to do so.[208] This can only be assessed on a case-by-case basis in the context of an actual bank resolution.

In the context of bail-in we briefly discuss below the potential protective effects of a collateral arrangement being entered into in respect of the ISDA Master Agreement given the exclusions from the scope of the bail-in tool and the terms of the exceptions to the protection conferred by the Bail-in Safeguards Order (defined below). The presence of an ISDA Credit Support Document may have a similarly beneficial impact on the robustness of the netting arrangement constituted by the ISDA Master Agreement in the context

204 Article 2 of the BRRD defines "derivative" as a derivative as defined in point (5) of Article 2 of EMIR (which in turn refers to a financial instrument as set out in points (4) to (10) of Section C of Annex I to Directive 2004/39/EC (**MiFID**) as implemented by Article 38 and 39 of Regulation (EC) No 1287/2006) and a "financial contract" as including the following: (a) securities contracts, including (i) contracts for the purchase, sale or loan of a security, a group or index of securities; (ii) options on a security or group or index of securities; (iii) repurchase or reverse repurchase transactions on any such security, group or index; (b) commodities contracts, including: (i) contracts for the purchase, sale or loan of a commodity or group or index of commodities for future delivery; (ii) options on a commodity or group or index of commodities; (iii) repurchase or reverse repurchase transactions on any such commodity, group or index; (c) futures and forwards contracts, including contracts (other than a commodities contract) for the purchase, sale or transfer of a commodity or property of any other description, service, right or interest for a specified price at a future date; (d) swap agreements, including (i) swaps and options relating to interest rates; spot or other foreign exchange agreements; currency; an equity index or equity; a debt index or debt; commodity indexes or commodities; weather; emissions or inflation; (ii) total return, credit spread or credit swaps; (iii) any agreements or transactions that are similar to an agreement referred to in point (i) or (ii) which is the subject of recurrent dealing in the swaps or derivatives markets; (e) inter-bank borrowing agreements where the term of the borrowing is three months or less; and (f) master agreements for any of the contracts or agreements referred to in points (a) to (e).

205 Note, in particular, the broad language of limb (d)(iii) of the definition of "financial contract" and point (10) of Section C of Annex I to MiFID.

206 Articles 3(3) and 4(3).

207 Article 5(1)(a).

208 In addition, to effect a partial property transfer of rights and liabilities under the ISDA Master Agreement would ostensibly be contrary to the 'no creditor worse off principle' and, in which case, may attract compensation pursuant to the Banking Act 2009 (Third Party Compensation Arrangements for Partial Property Transfers) Regulations (SI 2009/319).

of an exercise of the partial property transfer power, although the analysis in this context is less straightforward.

In relation to title transfer collateral arrangements, the Explanatory Memorandum to the Partial Property Transfer Delegated Act states that "[s]ome classes of arrangements should be protected simply due to their nature (for example, full title transfer security), as the application of the safeguards for these classes of arrangements is clear and straightforward." It therefore appears that the Partial Property Transfer Delegated Act is not intended, insofar as title transfer collateral arrangements are concerned, to represent a departure from the *status quo ante*. Accordingly, where the parties have entered into a 1995 ISDA Credit Support Annex, for instance, this may potentially serve to safeguard the operation of the close-out netting provisions of the ISDA Master Agreement, although this is far from certain.

In relation to a security interest collateral arrangement the effect is altogether more ambiguous. Article 2 of the Partial Property Transfer Delegated Act provides for the protection of "liens and other real securities interests" and, therefore, it seems plausible that article 5 of the Partial Property Safeguards Order (which relates to secured liabilities) could remain unaffected by the Partial Property Transfer Delegated Act. However, unlike in relation to bail-in where a secured liability is simply incapable of being bailed in to the extent of the security, a secured liability is capable of being transferred provided that the security and the liability are moved together. The Banking Act SRR Code of Practice states as follows:

> "This safeguard protects financial collateral and other secured arrangements to which the bank in SRR is party. It provides that where the bank or its counterparty has a security interest over an asset securing a liability owed to it by the other party, the charged asset may not be "split up" from this liability under a partial transfer. In this way, counterparties can continue to be confident that they will be able to have recourse to collateral assets over which they have taken security."

The potential effect of the article 5 safeguard, given that collateralisation under, for instance, the 1995 ISDA Credit Support Deed is performed on a net basis, could be that all Transactions representing liabilities that are secured are bound together by virtue of the security arrangement. This is certainly not, however, free from doubt and, in addition, note the following limitations: (i) as with bail-in below, article 5 is irrelevant where a Transaction representing a liability to the English Bank is not in fact secured because that party occupies an in-the-money position under the ISDA Master Agreement on a net basis and (ii) unlike bail-in, a partial property transfer is capable of affecting assets as well as liabilities of the English Bank and, therefore, in a partial property transfer scenario the reverse of (i) is also capable of being true, that is, a Transaction represents an asset to the English Bank but that party is out-of-the-money on a net basis so has provided collateral to the other party, and article 5 has no application in this fact pattern either.

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 to invalidate such exercise), then that partial property transfer will not affect the exercise of the 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. Article 12 deals with transfers that, although in contravention of the Partial Property Safeguards Order, are nonetheless legally effective, and which must therefore be reversed or otherwise remedied by the relevant Authority.

Therefore, on the basis of the Partial Property Safeguards Order and subject to the discussion above in respect of the Partial Property Transfer Delegated Act and also to the following paragraph, 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 the close-out netting provisions of an ISDA Master Agreement against the English Bank.

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. We are not aware of any explanation for this state of affairs. However, 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 close-out netting.

~~We also confirm that the inclusion under an ISDA Master Agreement of any rights or obligations that fall outside Appendix A and which are not protected rights and obligations within the scope of the Partial Property Safeguards Order (for example, a retail deposit) would not affect the enforceability of the ISDA Master Agreement in relation to any Transactions falling within the scope of Appendix A. In other words, the Partial Property Safeguards Order would protect a netting arrangement, such as an agreement in the form of the ISDA Master Agreement, in relation to all protected rights and liabilities within its scope, notwithstanding the inclusion within the scope of the netting arrangement of one or more rights or liabilities that are not protected.[174]~~

(iv) *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~~) (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.~~[175]~~[209] The purpose of these provisions is to ensure that the

~~174~~ ~~This point was not entirely clear under the Partial Property Safeguards Order prior to the amendment to the Partial Property Safeguards Order that came into effect on 9 July 2009, however, in our view, it is now clear.~~

~~175~~209 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) or 44D(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.

transferred bank or the transferee of any part of the business of the residual bank (as applicable) is able to operate the transferred business effectively.

Article 3(2) of the Partial Property Safeguards Order confirms that a partial property transfer within the scope of the Partial Property Safeguards Order (as to which see above) 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 or netting arrangement. Article 3(2) therefore protects the close-out netting provisions of an ISDA Master Agreement from being disrupted by the exercise of a continuity power where a partial property transfer has occurred, subject to the discussion above regarding the impact of the Partial Property Transfer Delegated Act. Article 10 of the Partial Property Safeguards Order confirms that a partial property transfer that included the exercise of a continuity power in contravention of article 3(2) would, to that extent, be void.

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[~~176~~210] and we consider it unlikely that such powers would be used in such a way as to disrupt the operation of the close-out netting provisions 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.

(v) *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. [~~177~~211]

Pursuant to section 48B(1), "special bail-in provision" means any of the following (or any combination of the following):

(A) provision cancelling a liability owed by the bank;

[~~176~~210] Sections 63(2) and 66(2) of the Banking Act.

[~~177~~211] A property transfer instrument under section 11(2), 12(2), 12ZA(3)~~ or~~, 41A(2)~~ or an associated~~, 43(2) or 44D(2) or a supplemental property transfer instrument, may also make special bail-in provision with respect to the bank (see ~~section~~sections 44B and 44BA 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.[~~178~~212]

The concern for the close-out netting provisions is primarily that special bail-in provision could apply so as to reduce or eliminate the amount owed by the English Bank under a Transaction with the effect that the ability of the other party to net amounts due in respect of those liabilities against liabilities owed by such party 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[~~179~~213] (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 or netting arrangement between the relevant person and the bank and that has not been converted into a net debt. For these purposes, "set-off arrangements" means arrangements under which two or more debts, claims or obligations can be set off against each other and "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 enabling them to be set off against each other or to be converted into a net debt.[~~180~~214]

We are of the view that the ISDA Master Agreement would be a "netting arrangement" or "set-off arrangement" for these purposes.[~~181~~215] 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 [~~182~~216] and unsecured liabilities owed to another member of the same

~~178~~212 Section 12A(2B) of the Banking Act.

~~179~~213 SI 2014/3350.

~~180~~214 Section 48P(2) of the Banking Act.

~~181~~215 While an ISDA Master Agreement with one Transaction may be capable of satisfying these definitions, liabilities are only protected for the purposes of the Bail-in Safeguards Order if a party is entitled to set-off or net them under that arrangement. In our view, where the Transaction is an executory contract, this requirement is likely satisfied. However, if the Transaction is categorised as a contingent obligation to pay a debt (for example, fully-paid options) this would not be the case (assuming all other obligations in respect of the Transaction have been performed) although, in these circumstances, we note that the close-out netting provisions would not, in any event, be deprived of their substance by a bail-in of the Transaction.

~~182~~216 Article 4(3)(d) of the Bail-in Safeguards Order.

group as the relevant bank which are not owed in relation to derivatives, financial contracts or qualifying master agreements.[~~183~~217]

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.[~~184~~218] 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.[~~185~~219]

To the extent that the Transactions 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 thereunder is otherwise a "qualifying master agreement", the operation of the close-out netting provisions of the ISDA Master Agreement 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 Transactions described in Appendix A will satisfy the definitions of either "derivative" or "financial contracts" (as those terms are defined in the Bail-in Safeguards Order) 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.[220]

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

~~183~~217 Article 4(3)(e) of the Bail-in Safeguards Order.

~~184~~218 Article 5 of the Bail-in Safeguards Order.

~~185~~219 Article 4(5) of the Bail-in Safeguards Order.

220 However to bail-in such Transactions on a gross basis would ostensibly be contrary to the 'no creditor worse off principle' and, in which case, may attract compensation pursuant to the Banking Act 2009 (Mandatory Compensation Arrangements Following Bail-in) Regulations (SI 2014/3330).

(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 close-out netting provisions of an ISDA Master Agreement against the English Bank.

Please note that although the Bail-in Safeguards Order acts to preserve the effect of the close-out netting provisions, any net sum owed by the English Bank as a result of the operation of such provisions 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 sum.~~[186]~~[221] Note that the Bail-in Safeguards Order provides, at article 4(2), that where the protected liability relates to a derivative, financial contract or qualifying master agreement it must be converted into a net debt, claim or obligation, whether in accordance with the relevant arrangement or through the making of special bail-in provision.[222]

Whilst not relevant on the facts you have asked us to assume, the Banking Act also provides that a 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.~~[187]~~[223] Secured for this purpose means secured against property or rights, or otherwise covered by collateral arrangements (which

~~186~~221 Article 4(6) of the Bail-in Safeguards Order.

222 See further Article 49 of the BRRD. Regarding the valuation of derivatives for bail-in see Commission Delegated Regulation (EU) 2016/1401 of 23 May 2016 supplementing Directive 2014/59/EU of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms with regard to regulatory technical standards for methodologies and principles on the valuation of liabilities arising from derivatives (the **Valuation RTS**). The Valuation RTS provides the detail in respect of the process for valuation of derivatives contracts when resolution authorities apply bail-in to derivatives liabilities. Pursuant to Article 4, the 'valuer' (meaning the independent expert appointed to carry out the valuation in compliance with the requirements and the criteria set out in Part Four of Commission Delegated Regulation (EU) 2016/1075 or the resolution authority when conducting the valuation pursuant to paragraphs (2) and (9) of Article 36 of Directive 2014/59/EU) shall determine, in respect of a netting agreement, a single amount which the institution under resolution has the legal right to receive or the legal obligation to pay as a result of the close-out of all derivative contracts in the netting set. The Valuation RTS goes on to provide, at Article 5, that the early termination amount shall equal "a close-out amount covering the amount of losses or costs incurred by derivative counterparties, or gains realised by them, by replacing or obtaining the economic equivalent of material terms of the terminated contracts and the option rights of the parties in respect of those contracts" and separately factors in unpaid amounts, collateral and other amounts due in each direction. Where a counterparty has provided evidence of 'commercially reasonable replacement trades' within the deadline set out in Article 3(3) of the Valuation RTS, the valuer shall determine the close-out amount at the prices of those replacement trades (Article 6(1)), subject to Article 6(2).

~~187~~223 Section 48B(7A) and (8)~~(b)~~ of the Banking Act in respect of excluded liabilities. Note the Bank of England also has the power under section 48B(7A)(b) and (10) to exclude any eligible liability or class of eligible liabilities from the application of any special bail-in provision in relation to the bank if the Bank of England thinks the exclusion is justified on one or more of the grounds set out at subsection (12) and notifies the European Commission of its intention to exclude the liabilities before making the instrument that gives effect to the exclusion and subject to the considerations at subsection (13). See also Commission Delegated Regulation (EU) 2016/860 of 4 February 2016 specifying further the circumstances where exclusion from the application of write-down or conversion powers is necessary under Article 44(3) of Directive 2014/59/EU of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms.

would extend to a title transfer collateral arrangement).~~188~~224 In respect of an ISDA Master Agreement collateralised by an English law 1995 ISDA Credit Support 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 New York law 1994 ISDA Credit Support Annex and the English law 1995 ISDA Credit Support Deed 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 the 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 one of the documents described above, such exclusions would *prima facie* 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~~addition, as mentioned above, section 48B of the Banking Act provides that a liability may not be subject to bail-in at all so far as it is secured~~ and, as~~. As the collateralisation under those ~~documents~~ISDA Credit Support Documents described above is performed on a net basis, ~~we would argue~~it is arguable that the liabilities under the ISDA Master Agreement would need to be converted (or treated as converted) into a net debt in accordance with the close-out netting provisions, against which the security interest under the New York law 1994 ISDA Credit Support Annex or English law 1995 ISDA Credit Support Deed would be applied or which would include the Unpaid Amount in respect of the English law 1995 ISDA Credit Support 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, likely ensure that the close-out netting provisions of the ISDA Master Agreement operate in accordance with their terms in the context of the bail-in of the ~~collateral provider.~~collateral-provider. We note, however, that the situation is not free from doubt. Note that the above discussion regarding netting protection in the context of a bail-in of secured liabilities under the ISDA Master Agreement is only relevant where the English Bank is collateral-provider under the relevant Credit Support Document. Where the English Bank has received collateral on account of a net in-the-money position the above arguments would not apply.

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

~~188~~224 Section 48D of the Banking Act.

of England must, where the section applies[~~189~~225] (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.[~~190~~226] Accordingly, the Transactions under the ISDA Master Agreement would not be directly affected by these provisions.

(vi) *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 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.[~~191~~227] See also part IV 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 to terminate and close-out Transactions in accordance with the close-out netting provisions 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

~~189~~225 See section 6A of the Banking Act for the circumstances in which section 6B applies. See section 81AA in respect of Banking Group Companies.

~~190~~226 These terms are defined in section 3 of the Banking Act.

~~191~~227 Section 48Z(7) of the Banking Act.

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.

The BRR Order 2016 includes changes to the mandatory default override in section 48Z to allow default event provisions to take effect in accordance with their terms notwithstanding section 48Z(6) if provided for in a Part 1 instrument or share transfer order (or to take effect to the extent specified in the instrument or order).[228] Such provision may be made only if the Bank of England (in the case of a Part 1 instrument) or HM Treasury (in the case of a share transfer order) considers that such provision would advance one or more of the special resolution objectives.

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.~~[192]~~[229] 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 during the stay period, while not being made by either party, will instead become due and payable at the end of such period (subject to the terms of the ISDA Master Agreement)~~[193]~~[230] and, if an Early Termination Date is designated under the ISDA Master Agreement and such amounts remain outstanding as at such Early Termination Date, will constitute Unpaid Amounts under such agreement. Therefore, such stayed payment or delivery obligations will still be taken into account for the purposes of Section 6(e) of the ISDA Master Agreement if the English Bank should become subject to formal insolvency proceedings. 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~~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

228 Article 15, BRR Order 2016 and section 48Z(6A) of the Banking Act.

~~192~~229 Section 70A(3) of the Banking Act.

~~193~~230 Section 70A(4) of the Banking Act.

providing for the suspension is published.[231] Noting that the restrictions under sections 70A 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 upon expiration of the stay, we do not consider that such powers have an impact on our conclusions herein regarding the enforceability of the close-out netting provisions.[232]

231 Note that, subject to section 48Z, termination rights can be exercised at the end of the suspension period pursuant to the contract, provided that, if the rights and liabilities have been transferred to another entity, the termination right must have been triggered by the new entity.

232 The restrictions in sections 70A and 70C do not apply to a party to a contract with the English Bank that is an "excluded person"as defined in section 70D.

(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 established under Part XV of the Financial Services and Markets Act 2000.[~~194~~233]

The detailed operation of the Bank Insolvency Procedure is subject to the Bank Insolvency (England and Wales) Rules 2009 (the **Bank Insolvency Rules**),[~~195~~234] which, for present purposes, are comparable to the provisions of the Insolvency (England and Wales) Rules ~~1986~~2016 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~~14.25 of the Insolvency ~~Rules 1986~~(England and Wales) Rules 2016. The application of Rule 72 is modified by Rule 73 in respect of protected deposits. There are some differences between the two provisions, but these have no bearing on our conclusions in this memorandum.[235]

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. In the event of an English Bank being made subject to the Bank Insolvency Procedure, the close-out netting provisions of the ISDA Master Agreement would be enforceable against the English Bank for the reasons we have given in part III.3(3)(a) of this memorandum in relation to an English Company.

~~194~~233 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.

~~195~~234 SI 2009/356, which came into effect on 25 February 2009.

235 Note that Rule 72 is based on Rule 4.90 of the Insolvency Rules 1986 and has not been updated to reflect changes to the winding up insolvency set-off rule made by Rule 14.25. For instance, Rule 72 continues to refer to a meeting of creditors under section 98 of the Insolvency Act 1986, now repealed by the Small Business, Enterprise and Employment Act 2015. Reference is also made to Rule 4.86 of the 1986 Rules which applies for the purpose of contingent obligations. Note also that Rule 74 (which also applies for the purposes of Rule 72 in relation to any sums due to the bank which are payable in a currency other than sterling) applies Rule 4.91 of the Insolvency Rules 1986 for the purposes of debts in a foreign currency. Rule 4.91 of the Insolvency Rules 1986 has now been replaced by Rule 14.21 of the Insolvency (England and Wales) Rules 2016. Note generally the discussion of the Dear IP Letter at part I.5 of 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.[~~196~~236] 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~~resolution company. 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~~resolution company that has acquired the transferred business to operate effectively.

The detailed operation of the Bank Administration Procedure is subject to the Bank Administration (England and Wales) Rules 2009 (the **Bank Administration Rules**),[~~197~~237] which are, for present purposes, comparable to the provisions of the Insolvency (England and Wales) Rules ~~1986~~2016 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 the Bank Administration Procedure, including Rule 2.85.[238]

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.

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. In the event of an English Bank being made subject to the Bank Administration Procedure, the close-out netting provisions of the ISDA Master Agreement would be enforceable against the English Bank for the reasons we have given in part III.3(3)(b) of this memorandum in relation to an English Company.

(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 two additional insolvency procedures that may be applied to it, namely Special Administration (Bank Insolvency) and Special

[~~196~~236] 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.

[~~197~~237] SI 2009/357, which came into effect on 25 February 2009.

[238] Note that the Bank Administration Rules have not been updated to refer to the Insolvency (England and Wales) Rules 2016.

Administration (Bank Administration) under the Investment Bank Special Administration Regulations 2011.[239]

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. 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).

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~~[198]~~[240] (the **Investment Bank Administration Rules**). The Investment Bank Administration Rules are, for present purposes, comparable to the provisions of the Insolvency (England and Wales) Rules ~~1986~~2016 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 close-out netting provisions of the ISDA Master Agreement against the English Bank.

[239] Various changes were made to the Investment Bank Special Administration Regulations 2011 by the Investment Bank (Amendment of Definitions) and Special Administration (Amendment) Regulations 2017 (for further details, see Annex 2).

~~[198]~~[240] SI 2011/1301, which came into effect on 30 June 2011.

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~~14.25 and Rule ~~2.85~~14.24 of the Insolvency (England and Wales) Rules ~~1986~~2016. 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~~14.25 and Rule ~~2.85~~14.24 of the Insolvency (England and Wales) Rules ~~1986~~2016, these differences have no bearing on our conclusions in this memorandum.[241]

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 (Bank Administration), as the case may be, these differences have no material effect on our conclusions in relation to the issues discussed in this memorandum. In the event of an English Bank that is an investment bank being made subject to either procedure, the close-out netting provisions of the ISDA Master Agreement would be enforceable against the English Bank for the reasons we have given in part III.3(3) of this memorandum in relation to an English Company.

[241] Note that Rule 166 (which also applies for the purposes of Rule 164 in relation to any sums due to the investment bank which are payable in a currency other than sterling) provides that for the purpose of proving a debt incurred or payable in a currency other than sterling, the amount of the debt shall be converted into sterling at the official rate prevailing on the date when the investment bank entered special administration. "The official exchange rate" means the mean of the buying and selling spot rates prevailing in the London market as published at the close of business for the date in question. In the absence of any such published rate, it is such rate as the court determines. This reflects the position in respect of administration set-off under the Insolvency Rules 1986 (which has now been superseded by Rule 14.21 of the Insolvency (England and Wales) Rules 2016 (see discussion at part III.3(4) of this memorandum)).

ANNEX 2

ENGLISH INVESTMENT FIRM

In this Annex 2, we set out our views regarding the enforceability of the close-out netting provisions of the ISDA Master Agreement 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 this memorandum.

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 ~~FSMA~~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. Conclusions

1.1 On the basis of the assumptions and subject to the qualifications in part III of this memorandum as modified and supplemented by this Annex 2, we are of the view that our conclusions in part III.3 would also apply to an English Investment Firm.

1.2 Subject to the analysis in this Annex 2, in the event that an English Investment Firm were made subject to the Bank Administration Procedure, Investment Bank Special Administration or Special Administration (Bank Administration) or became subject to the SRR, we are of the view that the close-out netting provisions of the ISDA Master Agreement would be enforceable against the English Investment Firm.

2. Analysis

2.1 *Winding Up Regulations*

As noted in Appendix D, 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 that the head office is in England.

Furthermore, in respect of English Investment Firms within the scope of the Winding Up Regulations, see paragraph 2.1 of Annex 1 and Appendix D in respect of the treatment of New York law governed ISDA Master Agreements.

2.2 *Insolvency proceedings under the Insolvency Act 1986 or scheme of arrangement under the Companies Act 2006*

The insolvency proceedings applicable to an English Company as set out in part III.1(4) of this memorandum 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 part III.3 of this memorandum as they would apply to an English Investment Firm.

2.3 *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 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~~[199]~~[242], but excluding:

(a) an institution which is also:

(i) ~~a~~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) an institution ~~within the scope of Article 29 of~~which is not required under provisions implementing the Capital Requirements Directive~~.~~~~[200]~~[243] to have initial capital of €730,000.[244]

~~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.

~~199~~242 Regulation (EU) No 575/2013 of the European Parliament and of the Council.

~~200~~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)~~of 26th June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC.

244 Banking Act 2009 (Exclusion of Investment Firms of a Specified Description) Order 2014 (SI 2014/1832), as amended by article 37 of the BRR Order 2016.

2.4 *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,[~~201~~245] which came into effect on 8 February 2011.

Under section 232 of the Banking Act, an "investment bank" is a UK institution that both 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.[~~202~~246]

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 eligible depositors 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.[~~203~~247]

Amendments were recently made to the Investment Bank Special Administration Regulations 2011 by the Investment Bank (Amendment of Definition) and Special

~~201~~245 SI 2011/245.

~~202~~246 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.

~~203~~247 Regulation 10.

Administration (Amendment) Regulations 2017[248], reflecting proposals following the review of the regime pursuant to section 236 of the Banking Act (which requires a review of the effect of the Regulations to be completed within 2 years of their coming into force). The amendments to Investment Bank Special Administration (with consequential effect in respect of Special Administration (Bank Insolvency) and Special Administration (Bank Administration)) include changes designed to facilitate the transfer of client assets from the failed investment firm to a solvent firm. Insofar as partial property transfers are concerned, however, there are restrictions imposed for the benefit of set-off and netting arrangements in similar terms to the Partial Property Safeguards Order.

The detailed operation of Investment Bank Special Administration is subject to the Investment Bank ~~Special~~ Administration ~~(England and Wales)~~ Rules ~~2011~~. ~~[204]~~ The Rules are, for present purposes, comparable to the provisions of the Insolvency (England and Wales) Rules ~~1986~~2016 that apply to the administration of a company. As discussed in Annex 1, Rule 164 sets out an insolvency set-off provision that, for present purposes, is substantially the same as Rule ~~2.85~~14.24 of the Insolvency (England and Wales) Rules ~~1986~~2016. There are some differences between the two provisions, but these have no bearing on our conclusions in this memorandum.[249]

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 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.~~[205]~~

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.~~[206]~~[250]

There are various technical differences between the administration of an English Company under the Insolvency Act 1986 and Investment Bank Special Administration,

248 SI 2017/443.

~~204~~ ~~SI 2011/1301, which came into effect on 30 June 2011.~~

249 See note 241.

~~205~~ ~~Regulation 8.~~

~~206~~250 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.

but these have no material effect on our conclusions in relation to the issues discussed in this memorandum. In the event of an English Investment Firm that is an investment bank being made subject to Investment Bank Special Administration, the close-out netting provisions of the ISDA Master Agreement would be enforceable against the English Investment Firm for the reasons we have given in part III.3(3)(b) of this memorandum in relation to an English Company.

(b) Special Administration (Bank Administration)

Article 10 of the Financial Services Act 2012 (Consequential Amendments and Transitional Provisions) (No 3) Order 2013[~~207~~251] 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).[~~208~~252] See Annex 1 to this memorandum for a discussion of the operation of Special Administration (Bank Administration) in relation to English Banks.

~~207~~251 SI 2013/1765.

~~208~~252 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.

ANNEX 3

ENGLISH BUILDING SOCIETY

In this Annex 3, we set out our views regarding the enforceability of the close-out netting provisions of the ISDA Master Agreement 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 part III of this memorandum as modified and supplemented by this Annex 3, we are of the view that our conclusions in part III.3 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 SRR under Part 1 of the Banking Act; (c) the Building Society Insolvency Procedure under Part 2 of the Banking Act; or (d) the Building Society Special Administration Procedure under Part 3 of the Banking Act.

2. Analysis

The conclusion in paragraph 1 of this Annex 3 is subject to the discussion below.

In paragraph 2.2 of this Annex 3, we discuss the enforceability of close-out netting 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 2.3 of this Annex 3, we discuss the enforceability of close-out netting 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. *Winding Up Regulations*

As noted in Appendix D, credit institutions are subject to the Winding Up Regulations. Therefore, see paragraph 2.1 of Annex 1 and Appendix D in respect of the treatment of New York law governed ISDA Master Agreements.

2.2. *Insolvency proceedings under the Building Societies Act 1986*

In this paragraph 2.2, 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.[~~209~~253]

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

[~~209~~253] 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.

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.[~~210~~254]

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 in part III.3 of this memorandum as they would apply to ~~a~~an English Building Society.[~~211~~255]

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 (England and Wales) Rules ~~1986~~2016, 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.[~~212~~256] Therefore, there is no statutory equivalent for building societies of the company insolvency set-off provision in Rule ~~4.90~~14.25 of the Insolvency (England and Wales) Rules ~~1986~~2016, 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.[~~213~~257] 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~~14.24 of the Insolvency (England and Wales) Rules ~~1986~~2016 in any insolvency rules applicable to an English Building Society, had they ever been adopted.

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

~~210~~254 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 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 under section 87 would not prejudice the enforceability of the early termination and close-out netting provisions of an ISDA Master Agreement entered into between an English Building Society and another party.

~~211~~255 For example, see Sections 89 and 90D of the Building Societies Act 1986.

~~212~~256 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.

~~213~~257 Section 249 Enterprise Act 2002.

favour of insolvency set-off in relation to English Building Societies are as strong as they are in relation to individuals or companies.[~~214~~258] The inclusion of statutory 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~~paragraph 2.3 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.

In any event, 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, without reliance on a statutory insolvency set-off rule, for the reasons we give in part III.3(3)(a) of this memorandum in relation to an English Company.

Similarly, we believe that there is no provision of the administration regime that would apply to an English Building Society that would materially adversely affect the enforceability of the close-out netting provisions of the ISDA Master Agreement, as discussed in part III.3(3)(b) of this memorandum in relation to an English Company.[~~215~~259]

We are also of the view that the close-out netting provisions of the ISDA Master Agreement would be enforceable against an English Building Society in the event of its entering into a CVA with its creditors under the relevant provisions of the Insolvency Act 1986 as modified and applied by the Building Societies Act 1986, for the reasons we give in part III.3(3)(c) of this memorandum in relation to an English Company.[260]

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[~~216~~261]. 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 of 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~~

~~214~~258 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: www.fmlc.org/uploads/2/6/5/8/26584807/118.pdf (accessed on ~~30 December 2015~~15 May 2017).

~~215~~259 We have already noted in the text above that the administration regime that would apply would, in any event, correspond to the regime applicable to companies prior to the Enterprise Act 2002. This, however, does not make a material difference to our analysis.

260 The amendments to Part I of the Insolvency Act 1986 for the purposes of its application to building societies pursuant to Schedule 15A of the Building Societies Act 1986 now fit uneasily with the amended provisions of the Insolvency Act 1986 following changes to Part I of the Insolvency Act to refer to the use of qualifying decision procedures. See in this regard the discussion of the Dear IP Letter at part I.5.

~~216~~261 SI 2010/1188.

~~receivers are omitted.~~.[262] Administrative receivership is available in respect of ‘relevant building societies’ under the Financial Assistance Order[263], 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.~~

In the limited circumstances described above in which an English Building Society could be made subject to an administrative receivership, the close-out netting provisions of the ISDA Master Agreement would be enforceable against the English Building Society for the reasons we have given in part III.3(3)(e) of this memorandum in relation to an English Company.

It is possible that an English Building Society could be made subject to a scheme of arrangement under Part 26 of the Companies Act for the reasons given in Annex 9 in relation to Chartered Corporations. The same arguments as apply in relation to Chartered Corporations would arguably also apply to an English Building Society.~~[217]~~[264]

2.3 *Banking Act*

The conclusions in part III.3(3) of 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~~1 in relation to an English ~~Investment Firm~~Bank 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

262 Building Societies Act 1986, Schedule 15A, para 27F.

263 See articles 11(2) and 11(6E).

~~217~~264 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 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.

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).[~~218~~265] 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,[~~219~~266] and

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.[~~220~~267] 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.[268] Note that, unlike the position in relation to bail-in as discussed below, it seems that the Partial Property Safeguards Order does not explicitly apply to the successor company as section 48 is not referenced in the table at section 84D.[269] We consider that this must be a legislative oversight, or that the intention is that the successor company will be caught by the safeguards by virtue of being a bank or by virtue of the relevant provisions of the SRR applying to the successor company "as they apply in relation to a bank"[270], as we see no reason not to extend such protection to a successor company. This memorandum is, however, qualified accordingly.

~~218~~265 Section 84 provides that the SRR applies to building societies as it applies to banks subject to the modifications in sections 84 to 84D.

~~219~~266 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.

~~220~~267 See explanatory note to the Building Societies (Bail-in) Order 2014/3344.

268 Note section 84D(5A) provides that, following the exercise of the powers under section 84A(5)(a) or 84A(5)(b), references to the bank in section 12ZA(1)(a) and any other provision so far as relating to property transfer instruments under section 12ZA include a reference to the successor company.

269 Section 84D(3) of the Banking Act.

270 Section 84D(2) of the Banking Act.

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.~~[221]~~[271] The exercise of the bail-in option in respect of an English Bank is discussed in ~~part~~paragraph 2.4(b)(v) of Annex 1 to this memorandum.

The BRR Order 2016[272] has inserted a new section 84ZA into the Banking Act, which relates to the exercise of the second stabilisation option (transfer to a bridge bank) in relation to a building society. The new section provides that a share transfer instrument under section 12(2)(a) may convert the building society into a company and make other provision for the purposes of, or in connection with, the conversion of the building society. Such provision includes that the resulting company be wholly owned by a bridge bank. Section 84D is also updated to provide that, where a share transfer instrument provides for a building society to be converted into a company under section 84ZA(2), the second stabilisation option is to be exercised by making (in that or a subsequent share transfer instrument) provision under section 12(2)(a) with respect to the successor company or, where such company upon creation is to be wholly owned by a bridge bank, the successor company or the bridge bank parent and, for these purposes, the provisions of the Banking Act specified in section 84D apply with the modifications stated. As discussed in connection with the bail-in option above, the Partial Property Safeguards Order seemingly does not explicitly apply to a successor company within the meaning of section 84ZA(2).

Both sections 84ZA and 84A also provide for the transfer of liabilities from the successor company to its parent undertaking (in relation to section 84ZA, where this is a bridge bank) or the replacement of a liability of the building society or successor company with a liability or security of the parent undertaking. The scope of such provision is unclear and could, at least in theory, affect the rights of the parties to the ISDA Master Agreement.

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.

~~In~~Subject to the analysis above, in the event of an English Building Society being made subject to the SRR in Part 1 of the Banking Act, the close-out netting provisions of the ISDA Master Agreement would be enforceable against the English Building Society for the reasons we have given in ~~part~~paragraph 2.4 of Annex 1 in relation to an English Bank.~~[222]~~[273]

(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 (as amended,

~~221~~271 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.

272 Article 21.

~~222~~273 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~~15 May 2017).

the **BSISA Order**),[~~223~~274]. 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**),[~~224~~275] which are, for present purposes, comparable to the provisions of the Insolvency (England and Wales) Rules ~~1986~~2016 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~~14.25 of the Insolvency ~~Rules 1986~~(England and Wales) Rules 2016.[276] The application of Rule 73 is modified by Rule 74 in respect of protected deposits. There are some differences between the two provisions, but these have no bearing on our conclusions in this memorandum.

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 2.2 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~~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.

[~~223~~274] SI 2009/805.

[~~224~~275] SI 2010/2581.

[276] Note that Rule 73 is based on Rule 4.90 of the Insolvency Rules 1986 and has not been updated to reflect changes to the winding up insolvency set-off rule made by Rule 14.25. For instance, Rule 73 continues to refer to a meeting of creditors under section 98 of the Insolvency Act 1986, now repealed by the Small Business, Enterprise and Employment Act 2015. Reference is also made to Rule 4.86 of the 1986 Rules which applies for the purpose of contingent obligations. Note also that Rule 75 (which also applies for the purposes of Rule 73 in relation to any sums due to the building society which are payable in a currency other than sterling) applies Rule 4.91 of the Insolvency Rules 1986 for the purposes of debts in a foreign currency. Rule 4.91 of the Insolvency Rules 1986 has been replaced by Rule 14.21 of the Insolvency (England and Wales) Rules 2016. Note generally the discussion of the Dear IP Letter at part I.5 of this memorandum.

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. In the event of an English Building Society being made subject to the Building Society Insolvency Procedure, the close-out netting provisions of the ISDA Master Agreement would be enforceable against the English Building Society for the reasons we have given in part III.3(3)(a) of this memorandum in relation to an English Company.

(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 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**).~~[225]~~[277] 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.[278] The modifications to Rule 2.85 for this purpose have no bearing on our conclusions in this memorandum.

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~~commercial purchaser or ~~bridge bank.[226]~~ resolution company.[279] 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 facilities required to enable a private sector purchaser or ~~bridge bank~~resolution company that has acquired the transferred business to operate effectively.

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

~~225~~277 SI 2010/2580.

278 Note that the BSSA Rules have not been updated to refer to the Insolvency (England and Wales) Rules 2016.

~~226~~ ~~In relation to the Dunfermline Building Society (regarding which see note 273), 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.~~

279 In relation to the Dunfermline Building Society (regarding which see note 273), 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.

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. In the event of an English Building Society being made subject to the Building Society Special Administration Procedure, the close-out netting provisions of the ISDA Master Agreement would be enforceable against the English Building Society for the reasons we have given in part III.3(3)(b) of this memorandum in relation to an English Company.

ANNEX 4

BANKING GROUP COMPANIES AND BANK HOLDING COMPANIES

In this Annex 4, we set out our views regarding the enforceability of the close-out netting provisions of the ISDA Master Agreement 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~~[227]~~[280]; (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 IV of this memorandum.

The definition of a 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).~~[228]~~[281]

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 this memorandum. 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

1.1 On the basis of the assumptions and subject to the qualifications in part III of this memorandum as modified and supplemented by this Annex 4, we are of the view that our conclusions in part III.3 would also apply to a Banking Group Company.

1.2 Subject to the analysis in this Annex 4, in the event that a Banking Group Company were made subject to the SRR or the Bank Administration Procedure under the Banking Act, we are of the view that the ~~close out~~close-out netting provisions of the ISDA Master Agreement would be enforceable against the Banking Group Company.

~~227~~280 Referred to as an English Banking Act Investment Firm in the context of Annex 2 in respect of English entities only.

~~228~~281 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

2.1 *Winding Up Regulations*

As noted in Appendix D, 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 in respect of the treatment of New York law governed ISDA Master Agreements.

2.2 *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**)[~~229~~282]; and

(b) that meets the conditions in the Banking Act 2009 (Banking Group Companies) Order 2014[~~230~~283] (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.

~~229~~282 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.

~~230~~283 2014/1831.

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[~~231~~284] (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.[~~232~~285]

Also excluded from the definition of banking group companies are securitisation companies which are not investment firms or financial institutions.[~~233~~286]

2.3 *Application of Part 1 of the Banking Act to a Banking Group Company*

The Bank of England may:[287]

(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.[~~234~~288]

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

~~231~~284 Directive 2002/87/EC.

~~232~~285 See article 2 of the Banking Group Companies Order for the full definitions.

~~233~~286 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.

287 See paragraph 2.5 below in respect of the ability of the Treasury to take a Bank Holding Company into temporary public ownership in accordance with section 13(2) of the Banking Act.

~~234~~288 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.

(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, 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 a 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 2.3 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.[~~235~~289]

[~~235~~289] 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 2(~~i~~j) in part III), 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.

2.4 *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, 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.[~~236~~290]

2.5 *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 2.5 apply substantially to a Bank Holding Company as if it were a Bank, Investment Firm or Building Society (as applicable), our conclusions in respect of each such English entities in Annex 1, Annex 2 and Annex 3 of this memorandum also apply to a Bank Holding Company.[~~237~~291]

~~236~~290 See note ~~235~~ 289 above in respect of the intra-UK jurisdictional issue.

~~237~~291 See note ~~235~~ 289 above in respect of the intra-UK jurisdictional issue.

ANNEX 5

TRUSTEE OF AN ENGLISH TRUST

In this Annex 5, we set out our views on the enforceability of the close-out netting provisions of the ISDA Master Agreement against ~~a~~the 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.4 of this memorandum, we only consider an English Trust that is not an English Charitable Trust, Authorised Unit Trust or an English Pension Fund or any 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~~the Trustee of an English Charitable Trust. In Annex ~~15~~14 we consider how the principles below apply in the case of ~~a~~the Trustee of an English Pension Fund. In Annex 16 we consider how the principles below apply in the case of the Trustee of an Authorised Unit Trust. As noted in part I.3(b)(iv) of this memorandum, any other form of English Trust that is subject to a special regulatory regime that may affect the enforceability of close-out netting under the ISDA Master Agreement 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~~the Trustee are the same as those that would apply in respect of an English Company, as described in part III.1(4) of this memorandum, since we have assumed in part I.3(b)(iii) 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~~[238]~~[292] 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 that the Trustee entered into the ISDA Master Agreement 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. We also make the equivalent assumptions as set out at part III.2(~~h~~i)(ii) and III.2(~~h~~i)(iii) in respect of the underlying English Trust.

1. Conclusion

On the basis of the assumptions and subject to the qualifications in part III of this memorandum as modified and supplemented by this Annex 5, we are of the view that our conclusions in part III.3 of this memorandum would apply to ~~a~~the Trustee of an English Trust

~~238~~292 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.

in the event that insolvency proceedings are commenced in England in respect of the Trustee or a Trust Insolvency (as defined below) occurs.

2. Analysis

We consider below the enforceability of the close-out netting provisions of the ISDA Master Agreement 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 (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**).

2.1 *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 ISDA Master Agreement (as parties thereto), 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 E); and

(b) a Partial Trustee Insolvency would not affect the enforceability of the close-out netting provisions of the ISDA Master Agreement against each remaining solvent Trustee which is party to the ISDA Master Agreement, as confirmed in part V of this memorandum, or interfere with the direct recourse of any such Trustee to the assets of the English Trust to satisfy its obligations under the ISDA Master Agreement, subject to the discussion in Appendix E.

2.2 *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.[~~239~~293] Where there is more than one Trustee, it is unlikely that all of the Trustees would be simultaneously insolvent.

~~239~~293 Although this risk is increased if there is a single Trustee.

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.[~~240~~294] Following such substitution, a party, by subrogation to the original Trustee's right of indemnity, would be entitled to enforce its subrogated right of indemnity against the trust assets directly, regardless of the fact that the 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 E. 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 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 E. 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.

If, however, a Full Trustee Insolvency were to occur, we believe that the ISDA Master Agreement and all Transactions 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 this memorandum, we believe that an English court would construe the close-out netting provisions of the ISDA Master Agreement 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) 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 (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 this memorandum. In relation to netting against a Trustee, however, there is an additional issue that must be considered.

Insolvency set-off under Rule ~~2.85~~14.24 of the Insolvency (England and Wales) Rules ~~1986~~2016, in the event of administration proceedings, or Rule ~~4.90~~14.25 of the Insolvency (England and Wales) Rules ~~1986~~2016, in the event of winding up proceedings, is limited to

~~240~~294 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.

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 at paragraph 2.3.

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.

2.3 *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~~the 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~~the Trustee is personally liable for the obligations it owes but not beneficially entitled to the obligations it is owed, which it holds for the benefit of the English Trust.

Notwithstanding the technical argument, provided the Trustee has incurred its obligations solely for the purposes of the English Trust and, subject to the issues discussed in Appendix E, 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~~the Trustee for purposes of the English Trust should therefore, in our view, be considered mutual ~~for the purposes of insolvency~~and therefore permit such obligations to be 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 E, 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), 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~~adopting a narrow 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).[~~241~~295] 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 to be set-off, whether in the case of a Full Trustee Insolvency or a Trust Insolvency.

~~241~~295 See, for example, *Hardoon v Belilios* [1901] AC 118 (PC).

In *Penwith District Council v V P Developments Limited*~~[242]~~[296] 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.~~[243]~~[297]

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 administration or 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~~Accordingly, Section 6(e) of the ISDA Master Agreement should work even on the basis of ~~an insolvency~~a set-off analysis.

2.4 *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.~~[244]~~[298] 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~~14.24 or Rule ~~4.90~~14.25 of the Insolvency (England and Wales) Rules ~~1986~~2016). To the extent a mandatory set-off rule is applied, we believe that the close-out netting provisions of the ISDA Master Agreement would be enforceable to the same extent on a Trust Insolvency as on a Full Trustee Insolvency.

As in the case of a Full Trustee Insolvency, 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 (whether by way of equitable or insolvency set-off) for the reasons set out in paragraph 2.3 above.

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 that the court would divide the assets of the insolvent trust in the following priority: (i) secured

~~242~~296 [2005] EWHC 259 (Ch)

~~243~~297 See also the discussion in Derham, *Derham on the Law of Set-off* (4th Edition, OUP 2010), para 17.122 to 17.126

~~244~~298 See, for example, *Gilbert Deya Ministries v Kashmir Broadcasting Corporation Ltd* [2010] EWHC 3015 (Ch), where the court held that an 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.

creditors; (ii) costs of realisation of assets; (iii) preferential creditors; and (iv) floating charges in the order of creation.[~~245~~299] 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) to 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 E, 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 English Trust will constitute an Event of Default in relation to the Trustee(s).

2.5 *Avoidance of Transactions – Partial Trustee Insolvency or Full Trustee Insolvency*

The Insolvency Act 1986 gives the court, subject to certain conditions, the power to avoid certain contracts or other transactions between a party and an entity subject to winding up or administration under the Insolvency Act 1986. For present purposes, the relevant provisions are section 238 (transactions at an undervalue), section 239 (preferences) and section 423 (transactions defrauding creditors). Either of these provisions could apply in the event of a Partial Trustee Insolvency or Full Trustee Insolvency.

These provisions are discussed in more detail in part III.3(3) of this memorandum. As a general rule, it is unlikely that these provisions will apply provided that the ISDA Master Agreement and each Transaction between a party and the insolvent Trustee were entered into by each of the party and the Trustee in good faith and at arm's length.

~~245~~299 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.

2.6 *Avoidance of Transactions – Trust Insolvency*

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.[~~246~~300]

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.

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 and is discussed at part III.3(3) of this memorandum. 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.

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.

~~246~~300 *Watts v Christie* (1849) 11 Beav 546, 50 ER 928.

ANNEX 6

FRIENDLY SOCIETY

In this Annex 6, we set out our views on the enforceability of the close-out netting provisions of the ISDA Master Agreement 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.

1. Conclusion

On the basis of the assumptions and subject to the qualifications in part III of this memorandum as modified and supplemented by this Annex 6, we are of the view that our conclusions in part III.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. Analysis

2.1 *Insolvency proceedings in respect of a Friendly Society*

Section 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).~~[247]~~[301] 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

~~247~~301 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 prejudice the enforceability of the early termination and close-out netting provisions of an ISDA Master Agreement entered into between ~~an~~a Friendly Society and another party.

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 (England and Wales) Rules ~~1986~~2016, 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~~14.25 of the Insolvency (England and Wales) Rules ~~1986~~2016, 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 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.[~~248~~302]

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 paragraph 2.1 of 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.[~~249~~303]

2.2 *Close-out netting against a Friendly Society*

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 this memorandum 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 a Friendly Society. Our reasons for this view are principally those set out in part III.3(3)(a) of this memorandum 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

~~248~~302 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 ~~30 December 2015~~15 May 2017).

~~249~~303 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 paragraph 2.1 of 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.

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.

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 this memorandum.

ANNEX 7

C/CB SOCIETY

In this Annex 7, we set out our views on the enforceability of the close-out netting provisions of the ISDA Master Agreement against a C/CB Society (formerly an Industrial & Provident Society)[~~250~~304] 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.

1. Conclusion

On the basis of the assumptions and subject to the qualifications in part III of this memorandum as modified and supplemented by this Annex 7, we are of the view that our conclusions in part III.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. Analysis

2.1 *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.[~~251~~305]

The Co-operative and Community Benefit 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

[~~250~~304] 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.

[~~251~~305] 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.

in *Re Norse Self Build Association*[~~252~~306] 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*[~~253~~307] would still apply as the relevant sections of the 2014 Act are substantially the same. This means that the Insolvency (England and Wales) Rules ~~1986~~2016 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~~14.25.

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)[~~254~~308] 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).[~~255~~309]

2.2 *Close-out netting against a C/CB Society*

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 this memorandum 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 this memorandum) 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 C/CB Society for the reasons set out in part III.3(3)(a) and (b) of this memorandum in relation to an English Company.

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 this memorandum.

~~252~~306 [1985] BCLC 219.

~~253~~307 [1985] BCLC 219.

~~254~~308 SI 2014/229.

~~255~~309 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.

ANNEX 8

STATUTORY CORPORATION

In this Annex 8, we set out our views on the enforceability of the close-out netting provisions of the ISDA Master Agreement 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 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.

1. Conclusion

On the basis of the assumptions and subject to the qualifications in part III of this memorandum as modified and supplemented by this Annex 8, we are of the view that our conclusions in part III.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.

2. Analysis

2.1 *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.[~~256~~310]

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.[~~257~~311] 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.[~~258~~312] 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 for purposes of the EC Insolvency Regulation. As England is part of the United Kingdom, which is an EU

[~~256~~310] 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*, vol 1 (~~18~~20th edn, Sweet & Maxwell ~~2015~~2017) ~~233~~242.

[~~257~~311] Council Regulation 1346/2000/EC on insolvency proceedings [2000] OJ L160.

[~~258~~312] *Re TXU Europe German Finance BV* [2005] BCC 90.

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 (England and Wales) Rules ~~1986~~2016 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~~14.25.[~~259~~313]

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.[~~260~~314]

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 paragraph 2.1 of 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.

2.2 *Close-out netting against a Statutory Corporation*

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 this memorandum 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

~~259~~313 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, 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 (except for the consideration of the Board of the Pension Protection Fund at Annex 14). See note 8.

~~260~~314 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.

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 this memorandum in relation to an English Company.

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 this memorandum.

ANNEX 9

CHARTERED CORPORATION

In this Annex 9, we set out our views on the enforceability of the close-out netting provisions of the ISDA Master Agreement 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.

1. Conclusion

On the basis of the assumptions and subject to the qualifications in part III of this memorandum as modified and supplemented by this Annex 9, we are of the view that our conclusions in part III.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. Analysis

2.1 *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.[~~261~~315]

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 paragraph 2.1 of 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.

~~261~~315 *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 ~~256~~310) refers to other cases that are similarly concerned with later proceedings in relation to a chartered company that was already in winding up.

Whether the winding up of a Chartered Corporation is conducted on a voluntary or compulsory basis, the provisions of the Insolvency (England and Wales) Rules ~~1986~~2016 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~~14.25.

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).~~[262]~~[316]

"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

~~262~~316 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.

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 9.

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.

2.2 *Close-out netting against a Chartered Corporation*

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 this memorandum 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 the Chartered Corporation for the reasons set out in part III.3(3)(a) of this memorandum in relation to an English Company.

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 this memorandum.

ANNEX 10

ENGLISH INSURANCE COMPANY

In this Annex 10, we set out our views on the enforceability of the close-out netting provisions of the ISDA Master Agreement 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 this memorandum;

(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 a 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.

1. Conclusion

On the basis of the assumptions and subject to the qualifications in part III of ~~of~~ this memorandum, as modified and supplemented by this this Annex 10, we are of the view that our conclusions in part III.3 of this memorandum would apply to an English Insurance Company in the event that insolvency proceedings are commenced in England in respect of the English Insurance Company.

2. Analysis

2.1 *English Insurance Companies*

As noted in part I.3 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.[263] 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**).~~

This regime has gone through substantive changes as a result of the implementation of the Solvency II Directive (2009/138/EC) (as amended by the Omnibus II Directive (2014/51/EU)) (the **Solvency II Directive**, also referred to as the level 1 framework Directive), which consolidates, with some amendments, a number of existing insurance and reinsurance Directives and provides the framework for a new EU solvency and supervisory regime for the insurance sector. The level 1 framework Directive is supplemented by the Commission Delegated Regulation (EU) 2015/35 (as amended by Commission Delegated Regulation (EU) 2016/467) (the **Delegated Regulation**) and a number of binding technical standards (together, the level 2 measures) and guidelines produced by the European Insurance and Occupational Pensions Authority (the level 3 measures).

In general, the Solvency II Directive applies to most English Insurance Companies with limited exceptions (in broad terms, those with gross premium income below €5 million and gross technical provisions of less than €25m). There are about 100 smaller English Insurance Companies (mainly Friendly Societies) that fall outside the scope of the Solvency II Directive. However, these firms may opt into the Solvency II regime and be subject to the same rules that apply to Solvency II firms.

Solvency II is transposed into UK law primarily by the Solvency 2 Regulations 2015 (SI 2015/575) (the **Solvency 2 Regulations**) with effect from 1 January 2016. The PRA and the FCA have provided rules and guidance to ensure firms' compliance with the new regime and have done so mainly by revising existing provisions in their respective rulebooks. In addition, the Solvency II level 2 measures take the form of EU Regulations and, as such, apply directly in the UK without the need for transposition.

~~263 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).~~

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,[~~264~~317] 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 and the Solvency II regime, 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 FCA Handbook. The ~~Financial Conduct Authority~~FCA 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~~Article 73 of the Solvency II Directive, and paragraph 2.3 of the PRA's Supervisory Statement SS8/15, an English Insurance Company will now, with certain exceptions, not be given permission to do so.[~~265~~318] 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 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 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.~~

~~264~~317 Financial Services ~~&~~and 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".

~~265~~318 See ~~INSPRU 1.5.17~~paragraph 2.3 of the PRA Supervisory Statement on composites SS8/15.

~~We assume for the purposes of the analysis in this Annex 10 that all Transactions 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.~~

2.2 *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 (England and Wales) Rules ~~1986~~2016 relevant to winding up, including the insolvency set-off provision in Rule ~~4.90~~14.25. Although the Insolvency (England and Wales) Rules ~~1986~~2016 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[319] (the **RWU Regulations**).~~[266]~~

In addition, the insolvency regime applicable to an English Insurance Company other than one established as a Friendly Society~~[267]~~[320] is subject to:

(i) Part XXIV (sections 355 – 379) of the Financial Services and Markets Act 2000;

319 SI 2004/353, as amended by paragraph 17 Schedule 2 to the Solvency 2 Regulations. Please note that various references to the Insolvency Rules 1986 in the RWU Regulations have not been updated to reflect the introduction of the Insolvency (England and Wales) Rules 2016.

~~266~~ ~~SI 2004/353.~~

~~267~~320 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.

(ii) the Insurers (Winding Up) Rules 2001 (the **Winding Up Rules**),[~~268~~321] made under section 379 of the Financial Services and Markets Act 2000; and

(iii) the Financial Services and Markets Act 2000 (Administration Orders Relating to Insurers) Order 2010 (the **Insurer Administration Order**),[~~269~~322] 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,[~~270~~323] 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.[~~271~~324] 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);[~~272~~325]

~~268~~321 SI 2001/3635. See the Insolvency (England and Wales) Rules 2016 (Consequential Amendments and Savings) Rules 2017/369, Schedule 2, para 6, in respect of the amendments to the Winding Up Rules to reflect the introduction of the Insolvency (England and Wales) Rules 2016.

~~269~~322 SI 2010/3023.

~~270~~323 See note ~~267~~320.

~~271~~324 Article 3 of the Insurer Administration Order applies the Insolvency Rules 1986 so far as they give effect to administration to relevant insurers. The Insurer Administration Order has not been updated to refer to the Insolvency (England and Wales) Rules 2016.

~~272~~325 Section 176ZA of the Insolvency Act 1986 (introduced by section 1282 of the Companies Act 2006), Rule 6.42 (in relation to creditors' voluntary winding up) and Rule ~~4.218~~7.108 (in relation to winding up by the court) of the Insolvency ~~Rules 1986 (introduced by The Insolvency (Amendment) Rules 2008 SI 2008/737)~~(England and Wales) Rules 2016 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,

(C) preferential creditors (discussed further below);

(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.[~~273~~326]

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 in relation to the period prior to insolvency proceedings now rank as ordinary unsecured claims.

The Enterprise Act 2002 also created a priority for unsecured creditors. Section 176A of the Insolvency Act 1986 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.

subject to Rules ~~4.218A to 4.218E~~6.44 to 6.48 (in relation to creditors' voluntary winding up) and Rules 7.111 to 7.116 (in relation to winding up by the court) of the Insolvency (England and Wales) Rules ~~1986~~2016, out of the property comprised in or subject to a floating charge created by the company. Rules ~~4.218A to Rule 4.218E~~6.44 to 6.48 and Rules 7.111 to 7.116 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.

~~273~~326 See also note ~~102~~ 113 in respect of depositor preference in respect of English Banks.

However, the position is considerably altered as regards ~~direct~~ insurance undertakings (that ~~is,~~are 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**)~~.~~, which has been consolidated into and repealed by the Solvency II Directive.[327]

~~The Insurance Winding Up~~Title IV of the Solvency II 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~~home member state in which the head office or branch is situated,[328] 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".[329]

Whichever system is chosen, precedence may also be given to the whole or part of the winding-up expenses.[330]

[327] Article 310 and Part A of Annex VI of the Solvency II Directive.
[328] Article 268(1)(a) of the Solvency II Directive.
[329] Article 275(1) of the Solvency II Directive.
[330] Article 275(2) of the Solvency II Directive.

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~~Title IV of the Solvency II Directive. The term "rights in rem" is not defined in ~~the Insurance Winding Up~~Title IV of the Solvency II 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.~~[274]~~[331] The RWU Regulations provide that such direct insurance debts must be paid out of the prescribed part in priority to all other unsecured claims.[332]

Accordingly, in the case of a winding-up~~[275]~~[333] 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:

(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 (~~B~~C) above); and

(ii) in relation to realisations of unsecured assets:

~~274~~331 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.

332 RWU Regulations, regulation 21(7).

~~275~~333 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 English 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 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.

(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 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.[~~276~~334] 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) Composites

The ~~special priority afforded to direct insurance claims detailed in (b) above[277] also applies to Composites which are direct insurance undertakings. In addition, the~~ RWU Regulations 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

~~276~~334 RWU Regulations, ~~reg~~regulation 8.

~~277~~ ~~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.~~

assets being applied to meet a deficit in the general business preferential and insurance liabilities and vice versa.[~~278~~335]

~~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.~~[~~279~~]

Accordingly, it is our view that, on the winding up of a non-transferring Composite, it may not be possible to net Transactions under the ISDA Master Agreement entered into in connection with the ~~English Insurance Company's~~Composite's long-term insurance business against Transactions entered into in connection with its general insurance business and such mingling of Transactions should be avoided. We have therefore assumed, for the purposes of the analysis in this Annex 10, that all Transactions 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.

We note that there are additional regulatory restrictions which apply to the segregation of an English Insurance Company's assets relating to its general insurance business and its long-term insurance business, and to the application of (or creation of a mortgage or charge over) the assets of an insurer's with-profits funds, and the importance of these restrictions is explained below.

(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 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

~~278~~335 An amendment to the RWU Regulations made by ~~reg~~regulation 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.

~~279~~ ~~There are some provisions in the RWU Regulations which suggests 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.~~

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 of the ISDA Master Agreement.

(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.~~~~[280]~~

The Companies Act 2006 scheme of arrangement provisions are, for present purposes, broadly the same as those in the Companies Act 1985.[336] The RWU Regulations do not directly apply to such schemes. However, in *Marconi Corporation plc v Marconi plc,*~~[281]~~[337] 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*~~[282]~~[338] 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.~~[283]~~[339]

~~280~~ ~~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.~~

336 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.

~~281~~337 [2003] EWHC 663 (Ch)

~~282~~338 [2003] EWHC 1969 (Ch), [2003] BCC 847

~~283~~339 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.

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 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 this Annex. 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.[~~284~~340]

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~~qualifying decision procedure to approve the company voluntary arrangement, to exercise its rights under the close-out netting provisions of the ISDA Master Agreement, 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.

(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.[~~285~~341] 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.[~~286~~342]

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.

~~284~~340 Paragraph 2 of Schedule A1 to the Insolvency Act 1986.

~~285~~341 Part VII of the Financial Services and Markets Act 2000 also deals with banking business transfer schemes, as discussed in Annex 1.

~~286~~342 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.

Section 112(1)[~~287~~343] 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 effectively override the right of a party to an ISDA Master Agreement with an English Insurance Company to designate an Early Termination Date as the result of an Event of Default or Termination Event under the ISDA Master Agreement that occurs as a result of something done or likely to be done in connection with an insurance business transfer scheme under Part VII.

We do not believe that an English court would make an order that would permit some, but not all, of the rights and liabilities under an ISDA Master Agreement to be transferred under an insurance business transfer scheme if the effect would be unfairly prejudicial to the other party to the ISDA Master Agreement, and therefore we do not believe that an order would be made that is inconsistent with our material conclusions in relation to the enforceability of close-out netting under the ISDA Master Agreement.

There may, however, be certain circumstances in which a party is prevented from designating an Early Termination Date in respect of the English Insurance Company where it would otherwise have had the right to do so. Any such order would be limited to the carrying out of the scheme, and would likely either involve the transfer of the whole of the ISDA Master Agreement (including all rights and obligations under the ISDA Master Agreement, each Transaction and any related Credit Support Document) to the transferee or would leave the ISDA Master Agreement with the original English Insurance Company. It would not prejudice, in our view, the right of the other party to designate an Early Termination Date under the ISDA Master Agreement as a result of an Event of Default or Termination Event constituted by any occurrence or condition in relation to the English Insurance Company after the transfer had been effected and the terms of the order complied with.

(h) Reduction of contracts

Section 377 of the Financial Services and Markets Act 2000[~~288~~344] 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.

~~287~~343 The remainder of section 112 clarifies and, in certain respects, extends the scope of the court's power under section 112(1).

~~288~~344 This provision does not apply to a Friendly Society. See note ~~267~~320.

Section 377 would not, in any event, appear to prevent, or give a court the power to prevent, the exercise by the Non-defaulting Party of its rights under the close-out netting provisions of the ISDA Master Agreement.

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[~~289~~345] 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.

~~289~~345 The Winding Up Rules do not apply to a Friendly Society. See note ~~267~~320.

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 within the definition of "bank" in section 2(1) of the Banking Act and is therefore *prima facie* within its scope.[~~290~~][346] 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[~~291~~][347] 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.

2.3 *Regulatory provisions*

~~The~~ 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, no breach of the provisions of the PRA Rulebook or the FCA Handbook by an English Insurance Company would prevent the other party from taking proceedings to enforce the ISDA Master Agreement against the English Insurance Company. However, 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 and to take enforcement action, 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.

In addition, the Regulators and the Secretary of State have powers under Part XXV of the Financial Services and Markets Act 2000 to seek an injunction from the High Court (in England and Wales) restraining a contravention of a requirement imposed by or under the Financial Services and Markets Act 2000, or restraining the disposition or dealing of assets, by a person who has contravened a requirement imposed by or under the Financial Services and Markets Act 2000, or a person knowingly concerned in such a contravention. Accordingly, there is a theoretical possibility that, in circumstances where an English Insurance Company has breached a requirement imposed by or under the Financial Services and Markets Act 2000, and where the other party was “knowingly concerned” in such a breach by the English Insurance Company, the PRA could apply for an injunction restraining the English Insurance Company or the other party from acting in contravention of such requirement or disposing of assets. Restitution awards are also possible in similar circumstances.

~~290~~346 "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".

~~291~~347 The Banking Act 2009 (Exclusion of Insurers) Order 2010 (SI 2010/35).

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 (even in circumstances where an agreement has been entered into in breach of the rules), it may be that an exercise of their powers could in certain circumstances affect the ability of ~~an~~the English Insurance Company to comply with its obligations under the ~~ISDA Master Agreement, as mentioned below.~~ Transactions. Accordingly, although breach of the PRA Rulebook and the FCA Handbook does not of itself call into question the enforceability of any Transaction, a breach could create circumstances which enable the Regulators to invoke powers, the exercise of which could be prejudicial to the English Insurance Company's and the other party's interests. This could include action by the Regulators which would curtail the income or capitalisation of the English Insurance Company (impairing its ability to pay) or affect the reputational standing of the English Insurance Company or the other party. We therefore outline below relevant parts of the PRA Rulebook and FCA Handbook that apply to an English Insurance Company which concern segregation of assets and which are therefore relevant to arrangements which contemplate netting.

(a) Separation of long-term insurance business of a Composite

Prior to the implementation of the Solvency II regime on 1 January 2016, the PRA Rulebook contained provisions:

(i) requiring an English Insurance Company to apply assets held in respect of its long-term insurance business only for the purposes of that long-term insurance business (INSPRU 1.5.30);

(ii) requiring an English Insurance Company to maintain a separate accounting record in respect of long-term insurance business (INSPRU 1.5.23);

(iii) requiring an English Insurance Company to separately identify and allocate receipts of its long-term insurance business (premiums and investment income) and the assets representing those receipts to a fund (known as the "long-term insurance fund") (INSPRU 1.5.24); and

(iv) preventing an English Insurance Company from agreeing to or allowing any mortgage or charge on assets held in respect of its long-term insurance business other than in respect of a long term liability (INSPRU 1.5.31).

~~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.~~[292]

~~292 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.~~

~~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").[293]~~

The effect of these provisions was to segregate the long-term insurance business of an English Insurance Company from its other business and accordingly, prior to the implementation of the Solvency II regime, it would have been a breach of INSPRU 1.5.30 for an English Insurance Company to permit the netting of Transactions entered into in connection with the English Insurance Company's long-term insurance business against Transactions entered into in respect of its other business, and consequently advisable to avoid such mingling of Transactions.[348] Equally, it would have been a breach of INSPRU 1.5.31 for an English Insurance Company to grant security over assets pertaining to a long-term insurance fund to secure obligations entered into in connection with its other business.

Following the implementation of the Solvency II regime, these rules have ceased to apply, and, in their place, rules have been introduced in the 'Composites' chapter of the PRA Rulebook which require an English Insurance Company within the Solvency II regime that is a Composite to separately manage its general insurance business activities and long-term insurance business activities in such a way that:

(i) its long-term insurance business and its general insurance business are distinct from one another (Composites 2.2(1));

(ii) the interests of policyholders of contracts of long-term insurance are not prejudiced by activities relating to the firm's general insurance business and the interests of policyholders of contracts of general insurance are not prejudiced by activities relating to the firm's long-term insurance business (Composites 2.2(2));

(iii) profits from the Composite's long-term insurance business benefit policyholders of long-term insurance as if the Composite was engaged only in long-term insurance business (Composites 2.2(3));

(iv) separate accounts relating to its long-term insurance business and its general insurance business are maintained (Composites 3.2).

~~293~~ ~~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.~~

348 It will normally be desirable to ensure that Transactions are all, in fact, entered into with, and expressed to be allocated to, 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.

Crucially, the rule (previously set out in INSPRU 1.5.30) prohibiting the application of assets of the long-term insurance fund to business other than long-term insurance business has ceased to apply, following the implementation of the Solvency II regime (and, in fact, the potential application of capital resources attributable to long-term insurance business to other parts of a Composite's business is contemplated in Composites 4.6).

Nonetheless, in practical terms, it is likely to be difficult for a counterparty to be able to evaluate due observance of the rules in the Composites chapter of the PRA Rulebook in connection with a transaction entered into by a Composite which envisages netting, unless that transaction is limited to its long-term insurance business or its general insurance business (but not both). In addition, as discussed above, the RWU Regulations continue to apply following the implementation of the Solvency II regime, such that, on the winding up of a non-transferring Composite, it may not be possible to net transactions entered into in connection with a Composite's long-term insurance business against transactions entered into in connection with its general insurance business.

On this basis, notwithstanding the introduction of the Solvency II regime, it would, in our view, be prudent to avoid mingling of transactions between the long-term insurance fund and the Composite's other business. We therefore continue to recommend that separate ISDA Master Agreements 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 would minimise the risk that any provision of the Composites part of the PRA Rulebook is breached.

(b) With-profits funds

If an English Insurance Company with long-term business *only*, or the long-term business segment of Composites, effects or carries out with-profits business, additional segregation requirements apply in relation to the assets comprising the English Insurance Company's with-profits fund. From 1 January 2016, an English Insurance Company effecting or carrying out with-profits insurance business is subject to the rules and guidance in the FCA Handbook relating to with-profits funds (COBS 20.1A). COBS 20.1A requires an English Insurance Company within the Solvency II regime to maintain separate accounting records for each of its with-profits funds and to ensure that the assets in its with-profits funds are separately identified and allocated to the relevant with-profits fund at all times. An English Insurance Company which carries out with-profits business must apply assets in a with-profits fund for the purposes of the business in that with-profits fund only (COBS 20.1A.10) and must not transfer assets out of a with-profits fund unless the assets represent a surplus (COBS 20.1A.8). In addition, an English Insurance Company which carries out with-profits insurance business is prevented from agreeing to, or allowing, any mortgage or charge on the assets in any of its with-profits fund other than in respect of that with-profits business (COBS 20.1A.11).

Pursuant to COBS 20.1A.2, the same treatment under COBS 20.1A applies in respect of each sub-fund of a with-profits fund, so that each sub-fund is treated as a distinct with-profits fund. A sub-fund may arise where an English Insurance Company which carries out with-profits insurance business identifies particular assets as forming a distinct part of its with-profits fund and restricts participation in the profits or other experience of that distinct part of the fund to a particular category of with-profits policies, for example as a consequence of a court order under Part VII of the Financial Services and Markets Act 2000 following a transfer of insurance business.

~~Furthermore, under INSPRU 1.5.30~~As a consequence of the provisions of COBS 20.1A, the assets of a ~~long-term insurance~~with-profits 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~~ business in that with-profits fund. Accordingly, in the case of Transactions under an ISDA Master Agreement with ~~a Life~~an English Insurance Company ~~or Composite (whether transferring or non-transferring):~~

which carries out with-profits business ~~(i)~~ it ~~would be~~is likely to result in a breach of ~~INSPRU 1.5.30~~the relevant rules under COBS 20.1A for an English Insurance Company which carries out with-profits insurance business to permit the netting of Transactions entered into in connection with ~~the English Insurance Company's long-term insurance business~~ its with-profits fund against Transactions entered into in ~~accordance~~connection with its other business, and therefore such mingling of Transactions should be avoided~~; and~~. The same would apply as regards granting security over assets of a with-profits fund to secure obligations entered into in connection with its other business.

~~(ii)~~ ~~it will normally be desirable to ensure that Transactions are all, in fact, entered into with respect to 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 in the with-profits fund, 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 with-profits fund, the entry into of the ISDA Master Agreement could be viewed as for the purpose of the long-term insurance for the purpose of the business in the with-profits fund to the extent that it supports such Transactions.

In our view the requirements set out in COBS 20.1A will continue to apply to an English Insurance Company carrying out with-profits insurance business 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 in circumstances where the liquidator or provisional liquidator causes the insurer to continue its business prior to such transfer.

(c) Imposition of requirements by the Regulators under the Financial Services and Markets Act 2000

An English Insurance Company may be subject to requirements imposed by the FCA or the PRA in accordance with sections 55L and 55M of the Financial Services and Markets Act 2000 in connection with the English Insurance Company's application for the Part 4A permission or for variation of such permission. Such requirements may extend to activities which are not regulated activities[349], and may be placed on the assets of the English Insurance Company. Assets requirements are requirements that:

(i) prohibit the disposal of, or other dealing with, any of the English Insurance Company's assets (whether in the United Kingdom or elsewhere) or restricting such disposals or dealings, or

(ii) require that all or any of the English Insurance Company's assets, or all or any assets belonging to consumers but held by the English Insurance Company or to its order, must be transferred to and held by a trustee approved by the appropriate regulator.

~~Section 138E~~In particular, section 55P 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 the other party from taking proceedings to enforce the ISDA Master Agreement~~where a requirement of the kind referred to in (ii) above is imposed on a person and while it is in force, no assets held in accordance with such requirement may be released or dealt with except with the consent of the Regulator which imposed the requirement (section 55P(7) of the Financial Services and Markets Act 2000) and any charge (to the extent that it confers security over the assets) created by the person over any of its assets held by a trustee in accordance with such requirement is void against the liquidator and any creditor of 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.~~ (section 55P(8) of the Financial Services and Markets Act 2000).

Accordingly, in the case of Transactions under an ISDA Master Agreement with an English Insurance Company which is subject to an asset requirement, it is likely to result in a breach of the relevant provisions of the Financial Services and Markets Act 2000 by the English Insurance Company if the entering into or the netting of the Transactions involves disposal or release of, or other dealing with, assets pertaining to an asset requirement. A breach of section 55P(7) further constitutes an offence with fine on summary conviction. We therefore assume, for the purposes of the analysis in this Annex 10, that the English Insurance Company is not subject to the exercise by either the PRA or the FCA of any powers conferred on such regulator by sections 55J to 55P (inclusive) of the Financial Services and Markets Act 2000 (nor have such powers become exercisable in respect of the English Insurance Company), in each case, in such a way which might affect the ability of the English Insurance Company to perform any or all of its obligations under the ISDA Master Agreement.

~~Accordingly, the concern of any potential party to an ISDA Master Agreement 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,~~

349 Section 55N, Financial Services and Markets Act 2000.

~~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 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 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~~d) Insurance business limitation

~~INSPRU 1.5.13 and 1.5.13A are~~Rule 9.1 in the 'Conditions Governing Business' part of the PRA Rulebook (**Conditions Governing Business**) is 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~~Rule 9.1(1) 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 ~~[294]~~ *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~~rule 9.1 of Conditions Governing Business should be noted as ~~they apply~~it applies to activities wherever carried on. This means

~~294 That is, the business of effecting or carrying out contracts of insurance as principal.~~

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~~rule 9.1 of Conditions Governing Business would continue to apply.

Two questions arise from this provision. First, would the entering into of derivative transactions 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~~rule 9.1 of Conditions Governing Business, 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~~the PRA Rulebook. 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.[~~295~~350]

More specifically, support for the view that English Insurance Companies may properly enter into derivative contracts ~~such as the Transactions~~ in relation to their insurance business is given by ~~INSPRU 3.2~~rule 5.2 of the 'Investments' part of the PRA Rulebook (**Investments**). This clearly envisages English 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 or agreements similar to the ISDA Master Agreement.

Based on this, we think that an English Insurance Company could enter into the Transactions in appropriate circumstances. Broadly, we think that Transactions would be entered into in appropriate circumstances if entered into for the purposes of efficient portfolio management or the reduction of investment risk in compliance with the requirements of ~~INSPRU 3.2~~rule 5.2(1) of Investments 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~~rule 9.1 (or as "related operations" for the purposes of ~~INSPRU 1.5.13A~~rule 9.2) of Conditions Governing Business.

~~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 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~~

~~295~~350 See *Liverpool and London Globe Insurance Company v Bennett* [1913] AC 610 at 621 (opinion of Lord Mersey)~~.~~

~~party. It also seems unlikely that the Regulator's supervisory powers could be used so as to affect the validity of an agreement entered into in breach of the rules.~~

~~Accordingly, the~~Any 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.~~

2.4 *Close-out netting against an English Insurance Company subject to insolvency proceedings*

We set out below our conclusions in relation to the enforceability of close-out netting 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 this memorandum 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 the English Insurance Company for the reasons set out in part III.3(3)(a) of this memorandum 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 this memorandum.

(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 this memorandum.

(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 this memorandum.

STANDARD CHARTERED BANK

In this Annex 11, we set out our views regarding ~~that~~the enforceability of the close-out netting provisions of the ISDA Master Agreement 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.[~~296~~351]

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,[~~297~~352] 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 part III of this memorandum and as modified and supplemented by this Annex 11, we are of the view that our conclusions in part III.3 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 in part III of this memorandum, the assumptions and qualifications in Annex 1 and Annex 9 to this memorandum and in this Annex 11, we are of the view that our conclusions in paragraphs 2.3 (Part VII of the Financial Services and Markets

~~296~~351 SI 2009/2436.

~~297~~352 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~~15 May 2017.

Act 2000) and 2.4 (Banking Act) of Annex 1 to this memorandum would also apply to Standard Chartered Bank.

2.3 Our analysis and conclusions in part IV of the memorandum in relation to an English Bank acting as a Multibranch Party under the ISDA Master Agreement would apply equally to Standard Chartered Bank acting as a Multibranch Party under the ISDA Master Agreement.

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 2.2 of Annex 1 would also apply relating to the powers of the FCA and the PRA on 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 the Charter*

As noted in Annex 9, in addition to statutory insolvency proceedings, Standard Chartered Bank could be wound up under the Charter~~[298]~~[353] 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;

~~298~~353 See Provision 20 of the Charter and Bye-Law 141

(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 branch of Standard Chartered Bank that is subject to winding up under that foreign insolvency law);~~299~~354 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 close-out netting provisions of the ISDA Master Agreement. Accordingly, we believe that the close-out netting provisions of the ISDA Master Agreement would be enforceable against Standard Chartered Bank even in circumstances where it was being wound up by its Court of directors in accordance with the provisions of the Charter described above.

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.

~~299~~354 Of course, as described in part IV of this memorandum, 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.

3.4 *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 2.3 of Annex 1 in relation to an English Bank, would also apply to Standard Chartered Bank. Our analysis of the potential effect of Part VII of the Financial Services and Markets Act 2000 on the enforceability of the close-out netting provisions of the ISDA Master Agreement in relation to an English Bank would apply equally in relation to Standard Chartered Bank, without additional qualification.

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 2.4 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 2.4 of Annex 1 to this memorandum regarding the enforceability of close-out netting provisions against 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 as a Multibranch Party and the Winding Up Regulations*

Standard Chartered Bank falls within the definition of "UK credit institution" in the Winding Up Regulations and is therefore subject to the Winding Up Regulations on the same basis as an English Bank. More generally, the fact that Standard Chartered Bank is a Chartered Corporation and not an English Company makes no material difference as far as the issues considered in part IV.3(1) of this memorandum are concerned. Our conclusion in part IV.3(1) of this memorandum therefore also applies to Standard Chartered Bank, without additional qualification.

See paragraph 2.1 of Annex 1 and Appendix D in respect of the treatment of New York law governed ISDA Master Agreements.

ANNEX 12

ENGLISH CHARITY – TRUSTEE OF AN ENGLISH CHARITABLE TRUST

In this Annex 12, we set out our views on the enforceability of the close-out netting provisions of the ISDA Master Agreement 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.

1. Conclusion

On the basis of the assumptions and subject to the qualifications in part III of this memorandum as modified and supplemented by Annex 5 and this Annex 12, we are of the view that our conclusions in part III.3 of this memorandum would apply to ~~a~~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 respect of the English Charitable Trust.

2. Analysis

2.1 *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.3, Appendix E and Annex 5. That analysis applies to the Trustee of an English Charitable Trust, as supplemented by this Annex 12.

2.2 *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, 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 and each Transaction with a party, and in performing any obligations of the Trustee on behalf of the English Charitable Trust, then the ISDA Master Agreement will be 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 ISDA Master Agreement or any Transaction 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 the ISDA Master Agreement or any Transaction against the Trustee.

Our analysis of the enforceability of the close-out netting provisions of the ISDA Master Agreement against the Trustee of an English Charitable Trust is not affected by whether the Trustee has entered into the ISDA Master Agreement or any Transaction 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.

2.3 *Close-out netting against ~~a~~the Trustee of an English Charitable Trust*

Our conclusions in part III.3 of this memorandum would apply to ~~a~~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 respect of the English Charitable Trust for the reasons given in Annex 5. In other words, the special regulatory regime that applies to an English Charitable Trust under the Charities Act 2011 has no material effect on the analysis and conclusions in Annex 5.[355]

355 We do not consider in this memorandum the various powers of the Charity Commission in respect of charities under the Charities Act 2011 in circumstances where the Charity Commission has instituted an inquiry under section 46 and is satisfied either as mentioned in section 76(1)(a) (regarding misconduct or mismanagement in the administration of the charity) or section 76(1)(b) (regarding the need to act to protect the property or the charity or secure a proper application of that property or property coming to the charity for the purposes of the charity). These powers include the power to appoint an interim manager to act as receiver and manager in respect of the property and affairs of the charity and, where the conditions in section 84B(1) are met, to direct its winding up (section 84B was added by the Charities (Protection and Social Investment) Act 2016).

ANNEX 13

ENGLISH CHARITY – OTHER FORMS OF ENGLISH CHARITY

In this Annex 13, we set out our views on the enforceability of the close-out netting provisions of the ISDA Master Agreement against an English Charity other than ~~a~~the Trustee of an English Charitable Trust in the event that insolvency proceedings are commenced in England in respect of the English Charity.

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 this memorandum;

(b) a Friendly Society, set out in Annex 6;

(c) an C/CB Society, set out in Annex 7;[~~300~~356]

(d) a Statutory Corporation, set out in Annex 8; and

(e) a Chartered Corporation, set out in Annex 9.

1. Conclusion

On the basis of the assumptions and subject to the qualifications in part III of this memorandum as modified and supplemented by this Annex 13, we are of the view that our conclusions in part III.3 of this memorandum would apply to an English Charity in the event that insolvency proceedings are commenced in England in respect of the English Charity.

2. Analysis

2.1 *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, 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 and each Transaction with a party, and in performing any obligations of the English Charity, then the ISDA Master Agreement will be 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 the ISDA Master Agreement or any Transaction 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.

~~300~~356 See note 13 in respect of English Charities established in the form of a C/CB.

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 obligations of the English Charity after the effective date of such revocation, but will not otherwise affect the enforceability of the ISDA Master Agreement or any Transaction against the English Charity.

Our analysis of the enforceability of the close-out netting provisions of the ISDA Master Agreement against an English Charity is not affected by whether the English Charity has entered into the ISDA Master Agreement or any Transaction 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.

2.2 *Insolvency proceedings against an English Charity*

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.[357]

2.3 *Close-out netting against an English Charity*

It follows from paragraph 2.2 above that the close-out netting provisions of the ISDA Master Agreement would be enforceable against an English Charity established as:

(a) an English Company, for the reasons set out in part III.3 of this memorandum;

(b) a Friendly Society, for the reasons set out in Annex 6;

(c) an C/CB Society, for the reasons set out in Annex 7;

(d) a Statutory Corporation, for the reasons set out in Annex 8; and

(e) a Chartered Corporation, for the reasons set out in Annex 9.

[357] See also note 355.

TRUSTEE OF AN ENGLISH PENSION FUND

In this Annex 14, we set out our views on the enforceability of the close-out netting provisions of the ISDA Master Agreement against the Trustee of an English Pension Fund 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 Pension Fund.

Subject to the more detailed discussion below, additional considerations apply in the context of an English Pension Fund to those analysed at Annex 5 in respect of an English Trust not subject to a special regulatory regime. In particular, for the purposes of this memorandum, in the case of a Trust Insolvency, the possibility exists that the Pensions Regulator could order the winding up of the English Pension Fund in accordance with its power to do so in certain circumstances under the Pensions Act 1995 and separate consideration should be given to the power of the PPF Board (as defined below) to take over the English Pension Fund.

Accordingly, in addition to the assumptions made in Annex 5, we assume for the purposes of this Annex 14 that the assets and liabilities of the English Pension Fund (in full or in part) have not been taken over by the PPF Board exercising the relevant power conferred on the PPF Board by the Pensions Act 2004.

1. Conclusion

On the basis of the assumptions and subject to the qualifications in part III of this memorandum as modified and supplemented by Annex 5 and this Annex 14, we are of the view that our conclusions in part III.3 of this memorandum would apply to the Trustee of an English Pension Fund 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 Pension Fund.

2. Analysis

2.1 *Application of general trust law to an English Pension Fund*

This Annex 14 should be read together with the analysis of Trustees and English Trusts elsewhere in this memorandum, in particular in part I.3, Appendix E and Annex 5. Such analysis applies to the Trustee of an English Pension Fund, as supplemented by this Annex 14.

As mentioned at part I.3, it is our understanding that an English Pension Fund will typically have a sole corporate Trustee and therefore the analysis at Annex 5 of this memorandum in respect of a Partial Trustee Insolvency should be ignored. In the case of a Full Trustee Insolvency, where there is a sole corporate Trustee which becomes insolvent, the trust deed would normally provide that the sponsoring employer may select a new Trustee, and the Pensions Regulator and the court have a statutory power to appoint a new Trustee subject to certain conditions specified by statute.

2.2 *Additional considerations in relation to an English Pension Fund – Trust Insolvency*

In this paragraph 2.2 and paragraph 2.3 below, we discuss certain further considerations that apply in respect of an English Pension Fund in addition to the analysis in respect of an ordinary English Trust as applied at paragraph 2.1 above. The focus of this paragraph 2.2 is Trust Insolvency. Paragraph 2.3 considers the powers of the PPF Board.

In respect of a Trust Insolvency, the possibility exists that the Pensions Regulator could order the winding up of the English Pension Fund in accordance with its power to do so in certain circumstances under the Pensions Act 1995. This is in addition to the possibility of a winding up under the trust deed (where the trust deed confers this power on the Trustee and the relevant circumstances have occurred, for example, the liquidation of the sponsoring employer or where the sponsoring employer has entered administration[358]) and the theoretical possibility that the court could make an administration order in relation to the Pension Fund under Rule 64.2 of the Civil Procedure Rules 1998, each discussed at Annex 5. As with these latter events, the winding up of the English Pension Fund by order of the Pensions Regulator 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 English Pension Fund will constitute an Event of Default in relation to the Trustee. There are no mandatory set-off rules that apply if an English Pension Fund is wound up (i) in accordance with its trust deed, (ii) under an administration order made under Rule 64.2 of the Civil Procedure Rules[359] or (iii) as a result of an order of the Pensions Regulator. In view of the power of the Pensions Regulator to order the winding-up of a Pension Fund (as well as its other regulatory powers), we believe that a court would be unlikely to intervene in the affairs of a Pension Fund by making an order under Rule 64.2 of the Civil Procedure Rules.

In relation to an English Pension Fund, it is usual for the trust deed to contain a provision stating that the insolvency of the sponsoring employer will trigger the winding up of the English Pension Fund. The sponsoring employer might also have the right to trigger a winding up of the English Pension Fund under the trust deed.

Although section 73 of the Pensions Act 1995 sets out the priorities for the distribution of an English Pension Fund's assets, section 73 applies to the satisfaction of "liabilities in respect of pensions and other benefits", and therefore we do not believe it applies to creditors of the English Pension Fund who are not beneficiaries. As described in Annex 5, if the English Pension Fund were wound up and there were insufficient assets to cover the entirety of the English Pension Fund's liabilities, we believe that the assets will be applied in the priority order suggested by the Trust Law Committee in the 1997 Consultation Paper. English Pension Fund trust deeds commonly provide that liabilities to third parties will be paid out before the remaining assets are applied towards providing the pension benefits for the members. Therefore, it is generally accepted, and it is our view, that any expenses, costs or liabilities properly incurred in connection with the English Pension Fund, including any liability to a counterparty to an ISDA Master Agreement, will be payable in priority to any pension benefits for members.

In any event, provided the Trustee's right of recourse to the trust assets is not impaired, the counterparty will have a right of recourse to the English Pension Fund secured by a Trustee's lien that will enable the Trustee to use the assets of the English Pension Fund to pay creditors in priority to the beneficiaries (because the Trustee's right of recourse will take priority over the beneficiaries' interests).

358 In practice, the winding up of an English Pension Fund on the grounds of its own insolvency is likely to relate to the insolvency of the employer and to lead to an assessment period commencing under the Pensions Act 2004, the implications of which are discussed below.

359 See Annex 5 in relation to the possibility of the application of insolvency set-off in this case.

As discussed above, the Pensions Regulator has the power to wind up an English Pension Fund. In addition, the Pensions Regulator has the power to issue a restoration order in relation to any transaction at an undervalue (defined in a manner similar to the Insolvency Act 1986 definition) where the transaction was entered into on or after 27 April 2004 and within two years prior to the employer entering into insolvency. Normally a transaction entered into by the Trustee with a market counterparty that acted in good faith and gave value for its side of the bargain will not be subject to a restoration order. The Pensions Regulator would bear the burden of proof in these circumstances. We are not aware of any specific counterpart of the Insolvency Act 1986 provision relating to preferences in relation to a winding up by the Pensions Regulator. However, as discussed in Annex 5, there is old jurisprudence which suggests that 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 (please refer to the discussion in Annex 5 for further details). There is also the possibility that the Pensions Regulator could seek an order under section 423 of the Insolvency Act 1986.

2.3 *Additional considerations in relation to an English Pension Fund – the Pension Protection Fund*

Following the establishment of the Pension Protection Fund under the Pensions Act 2004, in a number of cases an English Pension Fund will not, in fact, go into winding-up but rather its assets and liabilities will be transferred to the Board of the Pension Protection Fund, a statutory corporation established by the Pensions Act 2004 (the **PPF Board** and, when referring to the fund only, the **Pension Protection Fund**). Before this occurs, however, an assessment period arises under section 132 of the Pensions Act 2004, which can lead to various outcomes, only one of which involves the English Pension Fund being taken over by the PPF Board.

(a) Commencement of an assessment period

Under section 160 of the Pensions Act 2004 a transfer of pension fund assets and liabilities to the PPF Board could occur, as described in more detail below, after completion of an assessment period in relation to the English Pension Fund. The assessment period is triggered under sections 127 and 132(2) of the Pensions Act 2004 by a qualifying insolvency event in relation to the sponsoring employer of the English Pension Fund, for example, the entry of the sponsoring employer into administration.[360]

During the assessment period, the PPF Board would assess whether the English Pension Fund qualifies for the protection of the Pension Protection Fund. To qualify, an English Pension Fund must meet the eligibility requirements for such protection set out in the Pensions Act 2004 and must also have insufficient assets itself to provide the minimum level of benefits that would be payable by the PPF Board out of the Pension Protection Fund under the Pensions Act 2004 (the **Protected Liabilities**).

360 Sections 129 and 132(4) of the Pensions Act 2004 provide that an assessment period will start where the trustee or managers of an eligible scheme become aware that the sponsoring employer of the scheme is unlikely to continue as a going concern, where that sponsoring employer is of a prescribed description. The prescribed description of "employer" includes certain public bodies in relation to which it is not possible for a qualifying insolvency event to occur and charities which are not a company or other body corporate (regulation 7 of the Pension Protection Fund (Entry Rules) 2005).

During the assessment period, the Trustee would continue to manage the English Pension Fund as before, but benefits would stop accruing, contributions would cease and the Trustee would reduce benefit payments to the level of the Protected Liabilities. In addition, the PPF Board may make various directions to protect the position of the English Pension Fund, in particular in relation to the investment of assets of the English Pension Fund, the incurring of expenditure by the Trustee on behalf of the English Pension Fund and the conduct of legal proceedings on behalf of the English Pension Fund.

Absent an express contractual provision referring to the assessment period, however, the commencement of the assessment period would not have any effect on the terms of any contract, including an ISDA Master Agreement, entered into between the Trustee and any third party. The power of the PPF Board to make certain directions referred to above would not affect the terms and conditions of existing contracts, including an ISDA Master Agreement between a party and the Trustee of the English Pension Fund.

During the assessment period, in order to establish whether the scheme is able to meet the Protected Liabilities, the PPF Board must, under section 143 of the Pensions Act 2004, either:

(i) obtain a valuation of the English Pension Fund's assets and liabilities as at the date immediately before the qualifying insolvency event (a **s143 Valuation**); or

(ii) make a determination of the value of the English Pension Fund's assets and liabilities as at that date (a **s143 Determination**).[361]

The PPF Board's power to make a s143 Determination applies from 23 July 2012. The power was added to the legislation as, where an English Pension Fund is very underfunded or very overfunded, it was considered that undertaking a s143 Valuation led to disproportionate delay and costs.

(b) Outcomes following the end of an assessment period

At the end of the assessment period, there are, broadly speaking, four possible alternative states of affairs:

(i) rescue of the English Pension Fund;

(ii) continuation of the English Pension Fund as a closed scheme;

(iii) winding up of the English Pension Fund; or

(iv) transfer of the property, rights and liabilities of the English Pension Fund to the PPF Board.

(c) Rescue of the English Pension Fund

If the English Pension Fund is "rescued", then the assessment period will end and the English Pension Fund will continue with no impact on any ISDA Master Agreement

[361] Section 143 of the Pensions Act 2004, as introduced by the Pensions Act 2011, Schedule 4, paragraphs (5) and (6).

entered into between the Trustee of the English Pension Fund and a party, unless expressly provided for contractually. An English Pension Fund is "rescued" where either the employer is rescued as a going concern and retains responsibility for the English Pension Fund or another person has assumed responsibility for meeting the employer's liabilities in respect of that English Pension Fund.[362]

It is our view that no provision of the Pensions Act 2004 would prevent a party from exercising its contractual right under Section 6(a) of the ISDA Master Agreement to designate an Early Termination Date as a result of an Event of Default that was triggered by the commencement or continuation of an assessment period, even where the English Pension Fund was rescued during the course of the assessment period.

In our experience, however, Trustees of English Pension Funds have strongly resisted the inclusion of an additional Event of Default (or even an Additional Termination Event) that is triggered only by the commencement or continuation of an assessment period. In any event, we do not consider it necessary to include such an Event of Default (or Additional Termination Event) to deal with this case. The enforceability of the close-out netting provisions are unaffected.

(d) Continuation of the English Pension Fund as a closed scheme and application for reconsideration

If the s143 Valuation or s143 Determination shows that the English Pension Fund has sufficient assets to meet the Protected Liabilities but not to purchase the full benefits from an insurer, the PPF Board may, in certain circumstances, order that the English Pension Fund continue as a closed scheme under section 153 of the Pensions Act 2004. In that case, members will accrue no further benefits. It may also be the case that no further contributions will be paid into the English Pension Fund as the employer may be insolvent.

The continuation of the English Pension Fund as a closed scheme will have no impact on the ISDA Master Agreement entered into between the Trustee of the English Pension Fund and a party, unless expressly provided for contractually.

Note that if, following the s143 Valuation or s143 Determination, the assets of the English Pension Fund fall below the amount needed to meet the Protected Liabilities, then the English Pension Fund could be reconsidered for PPF entry. In summary, this could happen in one of two ways:

(i) if the assets fall below the amount needed to meet the Protected Liabilities within 6 months of the s143 Valuation or s143 Determination becoming binding the English Pension Fund may apply to be reconsidered by the PPF Board in accordance with section 151 of the Pensions Act 2004. The PPF Board will then issue a determination notice stating that it will assume responsibility for the English Pension Fund. That determination will not take effect for at least one month, so the other party would therefore have one month to exercise any Additional Termination Event or Event of Default inserted in respect of this eventuality; or

[362] See regulation 9(1)(a) of the Pension Protection Fund (Entry Rules) Regulations and section 122(5)(a) of the Pensions Act 2004.

(ii) if the assets fall below the amount needed to meet the Protected Liabilities while the English Pension Fund is operating as a closed scheme a further assessment period will start in accordance with section 159 of the Pensions Act 2004. This could result in one of the other outcomes described in this paragraph 2.3, for example, winding up or transfer of the English Pension Fund to the PPF Board.

It is our view that no provision of the Pensions Act 2004 would prevent a party from exercising its contractual right under Section 6(a) of the ISDA Master Agreement to designate an Early Termination Date as a result of an Event of Default that was triggered by the PPF Board ordering the English Pension Fund to continue as a closed scheme.

We expect, however, that the Trustee of the English Pension Fund would resist the inclusion of an additional Event of Default (or even an Additional Termination Event) that is triggered by such an order on the basis that the hedging arrangements under the ISDA Master Agreement might still be required by the Trustee where the English Pension Fund continues to operate.

In our view, it is not necessary to have an Event of Default (or Additional Termination Event) to deal with this possibility provided that the Trustee continues to perform its obligations under the ISDA Master Agreement. The other party's rights under the close-out netting provisions would not be affected by the operation of the English Pension Fund as a closed scheme.

(e) Winding up of the English Pension Fund

At the end of the assessment period, the English Pension Fund may be liable to winding up under the relevant provisions of its trust deed or as required by section 154 of the Pensions Act 2004 or by virtue of an order of the Pensions Regulator (or, increasingly rarely for the reasons discussed above, under an administration order from the court under Rule 64.2 of the Civil Procedure Rules). This may occur where the English Pension Fund has assets needed to fund benefits at a level above the level of the Protected Liabilities, but the English Pension Fund is not able to continue because, for example, the sponsoring employer has gone into liquidation.

We recommend that an additional Event of Default be added to the Schedule to the ISDA Master Agreement providing that the winding up of the English Pension Fund as required pursuant to section 154 of the Pensions Act 2004 will constitute an Event of Default in relation to the Trustee.

In this case, we would expect that the other party would designate an Early Termination Date under the ISDA Master Agreement with the Trustee of the English Pension Fund (where it has such a right), or, if the other party chose not to do that for any reason, we expect that the Trustee, needing to realise assets and crystallise liabilities of the English Pension Fund, would seek to negotiate a termination of the Transactions under that ISDA Master Agreement and the determination of a net balance owing by or to the Trustee of the English Pension Fund.

It is our view that no provision of the Pensions Act 2004 would prevent the other party from exercising its contractual right under Section 6(a) of the ISDA Master Agreement to designate an Early Termination Date as a result of an Event of Default that was triggered by the winding up of the English Pension Fund for any reason. As discussed in paragraph 2.2 above (and see above in this sub-paragraph (e) in respect of section 154 of the Pensions Act 2004), we believe that such an Event of Default should be included in order to permit the other party to operate the close-out netting provisions in the event of a winding up of the English Pension Fund.

(f) Transfer to the PPF Board

At the end of the assessment period, the English Pension Fund may have assets below the level needed to fund benefits at a level equal to or above the level of the Protected Liabilities. In this case, subject to certain conditions specified in the Pensions Act 2004, the PPF Board is required to assume responsibility for the English Pension Fund. It does this by giving the Trustee of the English Pension Fund a notice under section 160 of the Pensions Act 2004 (a **Transfer Notice**), which has the effect, under section 161 of, and Schedule 6 to, the Pensions Act 2004, upon receipt by the Trustee of the Transfer Notice of automatically transferring the property, rights and liabilities of the English Pension Fund to the PPF Board and discharging the Trustee from its obligations in relation to the English Pension Fund.

This means that the PPF Board, by operation of law, becomes the successor to the rights and liabilities of the Trustee of the English Pension Fund under any ISDA Master Agreement, including any Transactions entered into under the ISDA Master Agreement.[363]

This has a couple of consequences that may be of concern to the other party to the ISDA Master Agreement and that such party may therefore wish to protect against by an appropriate provision in the Schedule to the ISDA Master Agreement, as discussed in more detail below. The two principal consequences of potential concern to the other party are:

(i) a loss of priority relative to the beneficiaries of the English Pension Fund; and

(ii) the possibility of the PPF Board exercising a statutory power to modify or disclaim onerous contract terms, resulting in the modification or disclaimer of provisions of the ISDA Master Agreement, including the close-out netting provisions.

We deal with each of these in turn, before considering how these might be addressed in the ISDA Master Agreement.

(g) Loss of priority relative to beneficiaries of the English Pension Fund

Upon the transfer of the assets and liabilities of the English Pension Fund to the PPF Board, the beneficiaries of the English Pension Fund would under the Pensions Act 2004 become creditors of the PPF Board in relation to the Protected Liabilities, ranking *pari passu* with other creditors of the PPF Board, including the other party in relation

363 There may, however, be circumstances where only one employer becomes insolvent and only part of the English Pension Fund is taken over by the PPF Board. In these circumstances it is less clear that the PPF Board will, in fact, take over the ISDA Master Agreement as that agreement will be with the Trustee in relation to the English Pension Fund as a whole. The PPF Board has only recently had the first examples of parts of the English Pension Funds being taken over and has thus far taken the view that, in these circumstances, contracts entered into by the Trustee are not taken over by the PPF Board.

to Transactions under an ISDA Master Agreement originally entered into by that party with the Trustee of the English Pension Fund.

To this extent, the priority of the other party to the payment of the liabilities due under the ISDA Master Agreement would change relative to the beneficiaries since, as discussed above, any claim of the party under an ISDA Master Agreement against the Trustee of the English Pension Fund would rank ahead of the beneficiaries of the English Pension Fund on the winding up of the Trustee or of the English Pension Fund.

Balanced against this, the party would be a creditor of the PPF Board as a whole. Its recourse would not be limited to the assets that previously formed part of the assets of the English Pension Fund. Note, however, that the obligations of the PPF Board are not explicitly guaranteed by the UK government.

(h) The PPF Board's statutory power to modify or disclaim "onerous" contract terms

Regulation 2(1) of the Pension Protection Fund (General and Miscellaneous Amendments) Regulations 2006 (the **PPF Regulations**) gives the PPF Board the power (the **Disclaimer Power**) to disapply a term or condition of a contract relating to the property, rights or liabilities of an English Pension Fund (which would include an ISDA Master Agreement) where the PPF Board considers that term or condition to be onerous. Alternatively, the PPF Board may substitute for such term or condition a term or condition that it considers to be reasonable. It would therefore be open to the PPF Board to disapply or substitute any term of the ISDA Master Agreement that it considered to be onerous.

Please note that there is no authority yet available on the proper interpretation of this power, which gives broad discretion to the PPF Board. It is, therefore, difficult to say how broad this power is or whether any such exercise of this power by the PPF Board would be subject to judicial review. As the law currently stands, it must be assumed, therefore, that the PPF Board, at least potentially, would have the power to modify or disclaim the close-out netting provisions of the ISDA Master Agreement on the basis that those provisions constitute onerous contract terms for purposes of Regulation 2(1) of the PPF Regulations.[364]

(i) Protecting against loss of priority and the Disclaimer Power

The other party to the ISDA Master Agreement may or may not be willing, as a credit risk matter, to accept the loss of priority entailed by the transfer of the English Pension Fund to the PPF Board. This loss of priority would not, of itself, affect the enforceability of the close-out netting provisions against the PPF Board.

The Disclaimer Power, however, could adversely affect the close-out netting provisions. For this reason, we are of the view that:

[364] However, as a practical matter, we are not aware that the PPF Board has sought to use the Disclaimer Power to date in respect of an ISDA Master Agreement. The PPF Board has also stated in the PPF Guidance (defined below) that it "would not expect to use its power under regulation 2(1) to enable an "out of the money" derivative to be terminated. Nor would it expect to vary contractual netting terms or credit support agreements", and notes that "to date, the [PPF Board] has not identified any term that it would wish to disapply or vary under Regulation 2(1)". Additionally paragraph 4.4 of the PPF Guidance concludes that "having considered the purposes and scope of the power, the [PPF Board] considers it would not ordinarily seek to disapply or substitute terms in contracts that have been negotiated at arms' length by trustees in the ordinary course of their trustee business, even if it is felt that the trustees negotiated a poor deal. The [PPF Board] has decided that the test it will apply in exercising its power under regulation 2(1) is to disapply or vary contractual terms which are substantially unfair or manifestly prejudicial to those purposes."

(i) the counterparty should include a provision in the ISDA Master Agreement requiring the Trustee to notify that party when an assessment period commences, so that the party can heighten its monitoring of the English Pension Fund during the assessment period in view of the potential consequences described above; and

(ii) the counterparty must include in the ISDA Master Agreement an appropriate Event of Default or Additional Termination Event permitting the party to designate an Early Termination Date after the commencement of an assessment period and before the PPF Board issues a Transfer Notice.

As noted above, Trustees of English Pension Funds have strongly resisted Events of Default or Additional Termination Events that are triggered merely by the commencement or continuation of an assessment period. Trustees have argued that terminating at the commencement of an assessment period is too soon (given that it is not unusual for assessment periods to last for 2 or 3 years due to the length of time that it can take to prepare all the data that is required to undertake a s143 Valuation, assuming that the PPF Board does not make a s143 Determination rather than undertaking a s143 Valuation – a s143 Determination would be expected to take less time) and, in any event, would have an adverse effect on the financial condition of the English Pension Fund.

On the other hand, an Event of Default or Additional Termination Event triggered by the issue of the Transfer Notice risks occurring too late, since the other party's loss of priority will occur automatically and, more importantly, the Disclaimer Power will become available to the PPF Board at that point.

During the course of 2009 and early 2010, there were considerable discussions in the market between derivatives dealers and Trustees of English Pension Funds, with some background involvement of the PPF Board and of ISDA, as to the appropriate form of Event of Default or Additional Termination Event and, specifically, as to the appropriate trigger for such event.

As noted above, the principal point is to find an appropriate trigger that ensures that the other party has the right to designate an Early Termination Date in good time prior to the end of the assessment period. For this trigger, the market appears to have settled on the approval by the PPF Board under section 144 of the Pensions Act 2004 of a s143 Valuation of the English Pension Fund prepared in accordance with section 143 that shows that the English Pension Fund's assets are less than its Protected Liabilities. Following changes to the Pensions Act 2004 effective from 23 July 2012 this would apply equally to a s143 Determination that states that the English Pension Fund's assets are less than the Protected Liabilities. The approval of the s143 Valuation, or the s143 Determination, do not become binding until a period of at least 28 days has expired (under section 143A and section 145)[365]. The PPF Board may not issue a Transfer Notice until the s143 Valuation or s143 Determination under section 143 is binding[366] and only if the s143 Valuation confirms, or the s143 Determination states,

365 This period was shortened from two months on 30 April 2013 by the Pension Protection Fund, Occupational and Personal Pension Schemes (Miscellaneous Amendments) Regulations 2013 (SI 2013/627).

366 Section 160 of the Pensions Act 2004.

that the assets of the English Pension Fund are less than the Protected Liabilities[367], as well as satisfying various other eligibility criteria under the Pensions Act 2004.

This therefore appears to be a satisfactory compromise that is neither too early from the viewpoint of the Trustees (namely, the commencement of the assessment period) nor too late from the viewpoint of derivatives dealers (namely, the issue of the Transfer Notice).

While various formulations of such an Event of Default or Additional Termination Event have been discussed and, individual cases, agreed between Trustees and derivatives dealers, one sticking point in negotiations has been the desire of Trustees to include a proviso stating that the relevant Event of Default or Additional Termination Event does not occur if the PPF Board confirms in some form that it will not use the Disclaimer Power to override the close-out netting provisions of the ISDA Master Agreement. The problem has been finding a form of the proviso that would bind the PPF Board and would therefore provide sufficiently robust assurance to derivatives dealers that the enforceability of the close-out netting provisions would not be overridden by the PPF Board.

On 8 March 2010, the PPF Board issued Guidance in relation to the Disclaimer Power (the **PPF Guidance**).[368] In the PPF Guidance, among other things, the PPF Board sets out a form of Additional Termination Event that would permit a counterparty to an ISDA Master Agreement with the Trustee of an English Pension Fund to designate an Early Termination Date if the PPF Board approves a s143 Valuation that verifies that the Protected Liabilities of the English Pension Fund exceed its assets, subject to a proviso that if, prior to "termination" by the derivatives dealer, the PPF Board gives an irrevocable undertaking to the dealer in the form of a deed that the PPF Board will not exercise the Disclaimer Power in relation to the ISDA Master Agreement, then the Additional Termination Event will not occur (the **PPF Standard ATE**). The PPF Guidance and PPF Standard ATE were issued before the PPF's power to make a s143 Determination was inserted into the Pensions Act 2004 on 23 July 2012.

The counterparty is not obliged to use the specific form of Additional Termination Event recommended by the PPF Board, but since the issuance of the PPF Guidance it appears to have become a market standard provision in ISDA Master Agreements between the Trustee of an English Pension Fund and derivatives dealers, although there are some market participants who use it unamended and some who use it with various changes we have recommended. We recommend a number of amendments to the PPF Standard ATE to improve the clarity and certainty of the provision, as well as to improve protection for the counterparty – ISDA members are advised to seek further legal advice on specific points of drafting. We consider, however, that, because of the introduction of a new discretion from 23 July 2012 which allows the PPF Board to make a s143 Determination, this arguably makes it somewhat easier for a scheme to be brought into the PPF and provides for a new route for the scheme to be brought into the PPF by way of the s143 Determination and, as such, we advise that the PPF Standard ATE is amended at a minimum to reflect this change. This provision may also be

367 Sections 127(2)(a) and 128(2)(a) of the Pensions Act 2004.

368 A copy of the Guidance can be found on the website of the PPF Board at the following URL: http://www.pensionprotectionfund.org.uk/DocumentLibrary/Documents/onerous_contracts_response.pdf (accessed: 15 May 2017).

expressed to be an Event of Default rather than an Additional Termination Event, but, of course, it is likely that the Trustee of an English Pension Fund will resist this.

We note that the proviso only applies if the PPF Board issues a deed prior to the other party exercising its right to terminate. The onus will therefore be on the Trustee of the English Pension Fund to cause the PPF Board to issue the deed. If no deed is issued, the other party will have an unrestricted right to "terminate" upon the approval of a s143 Valuation or s143 Determination showing that the Protected Liabilities of the English Pension Fund exceed its assets.[369]

The counterparty will need to know that a relevant s143 Valuation or s143 Determination has been approved before it can exercise its rights, and therefore such party should require the Trustee to notify it if such a s143 Valuation or s143 Determination is approved. Given the possibility that the Trustee may, if not prompted by the other party, fail to notify it of the approval of a s143 Valuation or s143 Determination, it would be advisable for such party to monitor the English Pension Fund proactively while it is in an assessment period.

(j) Insolvency of the PPF Board

As the other party to the ISDA Master Agreement with the Trustee could, in certain circumstances (for example, where the PPF Board has given the deed referred to in (i) above) find itself party to an ISDA Master Agreement with the PPF Board, the party needs to consider the enforceability of the ISDA Master Agreement, including the close-out netting provisions, against the PPF Board, including in the event of insolvency proceedings (if possible) in relation to the PPF Board.

As noted above, the PPF Board is a body corporate established by the Pensions Act 2004. As such, it does not otherwise fall within the scope of this memorandum other than as separately confirmed and qualified by this Annex 14.[370]

The provisions of the Insolvency Act 1986 and related secondary legislation that apply to an English Company would not directly apply to the PPF Board. As discussed at Annex 8, there is good authority for the view that a statutory corporation organised by private Act of Parliament may be wound up as an "unregistered company" under section 221 of the Insolvency Act 1986.[371] *Obiter* comments of Denning LJ in the Court of Appeal decision in *Tamlin v Hannaford*[372], however, provide persuasive support for the view that a statutory corporation established by an Act of Parliament for a public purpose without private shareholders is not liable to be wound up at the suit of any creditor. An earlier case, *Re Exmouth Docks Co.*[373], suggested that a court would be unlikely to make a winding up order in relation to a statutory corporation

369 See note 364 above. Also note that paragraph 5.3 of the PPF Guidance states, in respect of the PPF Standard ATE, that "we would strongly encourage trustees and managers to adopt this wording in ISDA contracts which they enter into or which are entered into on their behalf by their fund managers" and notes at paragraph 7.4 that "[w]here a contract contains a termination event in a form materially similar to the wording set out in paragraph 5.2 of this guidance, the [PPF Board] will execute and issue to the counterparty a Deed in the form annexed to this guidance".

370 See note 8.

371 See, for example, *Re Oriental Bank Corporation* (1885) 54 LJ Ch 481, which establishes this principle in relation to earlier insolvency legislation.

372 [1949] 2 All ER 327.

373 (1873) LR 17 Eq 181.

established for a public purpose without a further Act of Parliament have been passed specifically to provide for the winding up.

The relationship between the decision in *Exmouth Docks* and the *obiter 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 such as a local authority without a further Act of Parliament. We are not aware of any relevant authority for the alternative view that a statutory corporation established for a public purpose may be wound up as an "unregistered company" under section 221 of the Insolvency Act 1986.

If the PPF Board cannot be compulsorily wound up under section 221 of the Insolvency Act 1986, it seems unlikely that there could be a voluntary winding up where the court has no jurisdiction to make a winding up order. In addition, there is no basis on which a statutory corporation would be made subject to an administration, company voluntary arrangement or scheme of arrangement under the Companies Act 2006.

In view of the conclusion that the PPF Board could not be wound up or made subject to any other form of insolvency proceeding under English law under current law (that is, without a further Act of Parliament), the provisions of the ISDA Master Agreement would be enforceable against the PPF Board under English law on the basis and subject to the assumptions and qualifications discussed in part V of this memorandum without further qualification by reference to English insolvency law.

If, contrary to our view, an English court were to determine that the PPF Board is an "unregistered company" for purposes of section 220 of the Insolvency Act 1986 and were to exercise its discretion to wind up the PPF Board as though it were an English Company, then, in our view, the close-out netting provisions would be enforceable against the PPF Board, assuming that the PPF Board had not effectively exercised its power to disapply or substitute those provisions (regarding the circumstances under which the PPF Board might exercise this power, see discussion above), just as they would against a Statutory Corporation wound up under section 221 of the Insolvency Act 1986, for the reasons stated in this memorandum in relation to an English Company.

2.4 *English Pension Fund Investment Managers*

A party may enter into the ISDA Master Agreement and one or more Transactions with an investment manager acting as agent on behalf of the Trustee of an English Pension Fund (rather than directly with the Trustee who may be acting on the advice of an investment manager). The investment manager will have been appointed by the Trustee pursuant to a power to do so in the trust deed for the English Pension Fund, 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 and each Transaction with a party, and in performing any obligations of the Trustee on behalf of the English Pension Fund, then the ISDA Master Agreement will be 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 ISDA Master Agreement or any Transaction 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 the ISDA Master Agreement or any Transaction against the Trustee.

Our analysis of the enforceability of the close-out netting provisions of the ISDA Master Agreement against the Trustee of an English Pension Fund is not affected by whether the Trustee has entered into the ISDA Master Agreement or any Transaction 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.

2.5 *Close-out netting against the Trustee of an English Pension Fund*

Our conclusions in part III.3 of this memorandum would apply to the Trustee of an English Pension Fund 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 Pension Fund for the reasons given in Annex 5 as supplemented by the analysis in this Annex 14.

ANNEX 15

ENGLISH INVESTMENT FUND – OPEN-ENDED INVESTMENT COMPANY

In this Annex ~~14~~15, we set out our views on the enforceability of the close-out netting provisions of the ISDA Master Agreement 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. [~~301~~374]

1. Conclusion

On the basis of the assumptions and subject to the qualifications in part III of this memorandum as modified and supplemented by this Annex ~~14~~15, we are of the view that our conclusions in part III.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. Analysis

2.1 *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~~FCA 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[~~302~~375]), a non-UCITS retail scheme or a non-retail scheme (otherwise known as a "qualified investor scheme").

Our conclusions regarding the enforceability of the ISDA Master Agreement against an Open-Ended Investment Company, both in the absence of insolvency proceedings (as confirmed in part V) and in the event that insolvency proceedings are commenced in England in respect of the Open-Ended Investment Company 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).

2.2 *Authorised corporate director or investment manager for the Open-Ended Investment Company*

~~301~~374 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)).

~~302~~375 Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS).

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.[~~303~~376]

In practice, a party may enter into an ISDA Master Agreement, 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 representative has the appropriate authority to act on behalf of the company when entering into an agreement such as the ISDA Master Agreement. We have assumed, among other things, that the persons entering into the ISDA Master Agreement on behalf of each party have the necessary authority. When a party enters into an ISDA Master Agreement 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 and each Transaction with a party, and in performing any obligations of the Open-Ended Investment Company, then the ISDA Master Agreement will be 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 ISDA Master Agreement or any Transaction 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 the 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 ISDA Master Agreement or any Transaction against the Open-Ended Investment Company.

~~303~~376 COLL 6.5.3.

Our analysis of the enforceability of the close-out netting provisions of the ISDA Master Agreement against an Open-Ended Investment Company is not affected by whether the Open-Ended Investment Company has entered into the ISDA Master Agreement or any Transaction 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~~15.

2.3 *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~~15. Whether the winding up of an Open-Ended Investment Company is conducted on a voluntary or compulsory basis, the provisions of the Insolvency (England and Wales) Rules ~~1986~~2016 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~~14.25.

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.[~~304~~377]

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.[~~305~~378]

2.4 *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 repsect

~~304~~377 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.

~~305~~378 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.

of companies[~~306~~379]. 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[~~307~~380]. Furthermore, any provision of an agreement~~,~~ or 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[~~308~~381]. Therefore, any provision of an ISDA Master Agreement 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.

2.5 *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~~15 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.

2.6 *Close-out netting against an Open-Ended Investment Company*

In respect of an Umbrella OEIC, the following analysis is subject to the requirements that (i) a separate ISDA Master Agreement 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. ~~Whilst not strictly necessary because the sub-fund does not have its own legal personality,~~Section 5 of the ISDA Master Agreement was not drafted with an umbrella structure in mind. We therefore recommend that parties contracting with an Umbrella OEIC ~~may wish to~~ clarify that Bankruptcy under Section 5 of the ISDA Master Agreement would

~~306~~379 Regulation 11A (5) and (6) of the OEIC Regulations.

~~307~~380 Regulation 3 of the 2011 Regulations creating *inter alia* a Regulation 11A in the OEIC Regulations.

~~308~~381 Regulation 11A (3) of the OEIC Regulations.

~~still~~ be triggered if the events occurred only in respect of the relevant sub-fund and not the Umbrella OEIC as a whole.

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 this memorandum 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 the Open-Ended Investment Company or sub-fund thereof for the reasons set out in part III.3(3)(a) of this memorandum in relation to an English Company.

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 this memorandum.

ENGLISH INVESTMENT FUND – TRUSTEE OF AN AUTHORISED UNIT TRUST

In this Annex ~~15~~16, we set out our views on the enforceability of the close-out netting provisions of the ISDA Master Agreement against the Trustee of an Authorised Unit Trust[~~309~~382] 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.

1. Conclusion

On the basis of the assumptions and subject to the qualifications in part III of this memorandum as modified and supplemented by Annex 5 and this Annex ~~15~~16, we are of the view that our conclusions in part III.3 of this memorandum would apply to ~~a~~the Trustee of an Authorised Unit Trust 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.

2. Analysis

2.1 *Application of general trust law to Authorised Unit Trusts*

This Annex ~~15~~16 should be read together with the analysis of Trustees and English Trusts elsewhere in this memorandum, in particular in part I.3, Appendix E and Annex 5. That analysis applies to the Trustee of an Authorised Unit Trust, as supplemented by this Annex ~~15~~16.

2.2 *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~~FCA was given 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[~~310~~383]), a non-UCITS retail scheme or a non-retail scheme (otherwise known as a "qualified investor scheme").

Our conclusions regarding the enforceability of the ISDA Master Agreement against ~~a~~the Trustee of an Authorised Unit, both in the absence of insolvency proceedings (as confirmed in part V of this memorandum) and 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, 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).

~~309~~382 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~~COLL).

~~310~~383 Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS).

2.3 *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, 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 and each Transaction with a party, and in performing any obligations of the Trustee on behalf of the Authorised Unit Trust, then the ISDA Master Agreement will be 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 ISDA Master Agreement or any Transaction 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 the ISDA Master Agreement or any Transaction against the Trustee.

Our analysis of the enforceability of the close-out netting provisions of the ISDA Master Agreement against the Trustee of an Authorised Unit Trust is not affected by whether the Trustee has entered into the ISDA Master Agreement or any Transaction 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~~16.

~~2.4~~ ~~*Close-out netting against a Trustee of an Authorised Unit Trust*~~

2.4 *Investment Bank Special Administration*

The Investment Bank (Amendment of Definition) and Special Administration (Amendment) Regulations 2017, amend the definition of "investment bank" for the purposes of sections 232 to 236 of the Banking Act to include an institution which has permission under Part 4A of the Financial Services and Markets Act 2000 to carry on the regulated activity specified by article 51ZB of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (acting as trustee or depositary of a UCITS) or article 51ZD of that Order (acting as trustee or depositary of an AIF). Accordingly, the Trustee of an Authorised Unit Trust may now be subject to Investment Bank Special Administration in addition to the insolvency proceedings that may be commenced in respect of an English Company as described in part III.1(4) of this memorandum (please refer to Annex 2 of this memorandum for details in respect of Investment Bank Special Administration). The discussion of mutuality for insolvency set-off purposes at Annex 5 should be construed *mutatis mutandis* to apply to Investment Bank Special Administration in the context of the Trustee of an Authorised Unit Trust becoming subject to such insolvency proceeding.

2.5 *COLL 7.4*

For completeness we briefly consider, at this paragraph 2.5, the procedure set out at chapter 7.4 of COLL. COLL 7.4 deals with the circumstances and manner in which an Authorised Unit Trust is to be wound up or a sub-fund of an Authorised Unit Trust is to be terminated. An Authorised Unit Trust may be subject to the procedure at COLL 7.4 in the case of a Trust Insolvency when the Authorised Unit Trust is being wound up, although the trigger for its application will not be the Trust Insolvency directly. In our view, the procedure in COLL 7.4 would be followed when an Authorised Unit Trust is being wound up in a Trust Insolvency.

In order to wind up an Authorised Unit Trust under COLL 7.4, notice is to be given to the FCA and the FCA will approve the winding up. Upon the commencement of a winding up, (i) unitholders must be notified (this can also occur prior to winding up commencing), (ii) normal business must cease, (iii) the Trustee must realise the assets (if any), (iv) all liabilities and costs of the winding up must be paid, (v) the units cancelled and (vi) proceeds distributed to unitholders.[384] Within 4 months of the final accounting period the manager or Trustee must send an annual log report to the FCA and make this available to unitholders. Upon completion of the winding up of the Authorised Unit Trust, the Trustee or manager must request the FCA to revoke the authorisation order of the Authorised Unit Trust. There are no mandatory set-off rules that apply if an Authorised Unit Trust is wound up under COLL 7.4.

We are of the view that nothing in COLL 7.4 would affect the enforceability of the close-out netting provisions of the ISDA Master Agreement against the Trustee of an Authorised Unit Trust. A winding up of the Authorised Unit Trust under COLL 7.4 would not, however, 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 commencement of a winding up under COLL 7.4 in relation to the Authorised Unit Trust will constitute an Event of Default in relation to the Trustee.

2.6 *Close-out netting against the Trustee of an Authorised Unit Trust*

Our conclusions in part III.3 of this memorandum would apply to ~~a~~the Trustee of an Authorised Unit Trust 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 for the reasons given in Annex 5 as supplemented by the analysis in this Annex 16. In other words, 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 and conclusions in Annex 5~~.~~ ~~[311]~~(except that consideration should be given to the application of COLL 7.4 in respect of the Authorised Unit Trust and also the possibility of Investment Bank Special Administration in respect of the Trustee).[385]

384 For an Authorised Unit Trust which is a relevant pension scheme, payments must not be made to unitholders in the Authorised Unit Trust, the realisation proceeds having to be paid by the trustee in accordance with the trust deed.

~~311~~ ~~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.~~

385 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.

ENGLISH PARTNERSHIP

In this Annex 17, we set out our views on the enforceability of the close-out netting provisions of the ISDA Master Agreement against an English Partnership in the event that insolvency proceedings are commenced in England in respect of the English Partnership.

An English Partnership contracts through the agency of its partners and, in the case of a Limited Partnership, through its general partner. As discussed at part I.3(c) of this memorandum, we assume that each of the individual partners in a General Partnership and the general and limited partners in a Limited Partnership are English Companies. We also assume that the English Partnership is not an agricultural partnership that has granted an agricultural charge to any creditor.

Subject to the more detailed discussion below, the types of insolvency proceeding that may be commenced in England in respect of an English Partnership are a winding up,[386] administration or the entry into of a partnership voluntary arrangement. For the avoidance of doubt, in this Annex, with the exception of the discussion at paragraph 2.1 below concerning the effect of concurrent insolvency proceedings, we do not consider insolvency proceedings in relation to one or more partners of the English Partnership. We assume that no petition for an administration order against the English Partnership was presented before 1 July 2005. The reason for this assumption is because the rules described below in this Annex relating to the administration of an English Partnership apply only where the petition for the administration order is presented on or after 1 July 2005. Prior administrations are governed by alternative rules.

1. Conclusion

On the basis of the assumptions and subject to the qualifications in part III of this memorandum as modified and supplemented by this Annex 17, we are of the view that our conclusions in part III.3 of this memorandum would apply to an English Partnership in the event that insolvency proceedings are commenced in England in respect of the English Partnership.

2. Analysis

2.1 *Insolvency proceedings in respect of an English Partnership – concurrent insolvency proceedings*[387]

An English Partnership is not a separate legal entity, even though it is treated as such for the purposes of certain insolvency proceedings under the Insolvency Act 1986. The partners themselves may be subject to separate insolvency proceedings and, to the extent the individual partners would be subject to insolvency proceedings in England as opposed to any other jurisdiction, the corporate insolvency regimes under the Insolvency Act 1986 would (subject to certain amendments under the Insolvent Partnerships Order, defined and discussed further

386 For the purposes of this Annex, "winding up" is used to denote winding up proceedings in respect of the English Partnership under the Insolvency Act 1986. "Winding up", when used (outside this memorandum) in a non-insolvency context in relation to a partnership, denotes the process whereby the affairs of the partnership are sorted out after the partnership has been dissolved.

387 The following analysis in relation to concurrent insolvency of the English Partnership and an individual partner of that English Partnership is only relevant to the extent that the individual partner is subject to insolvency proceedings in England. We do not comment for the purpose of this memorandum on any insolvency proceeding in respect of an individual partner which takes place in any jurisdiction other than England.

below) apply to the partners upon their insolvency. There are also instances where the insolvency proceedings of the English Partnership and the insolvency proceedings of one or more of its partners may not be treated as isolated insolvency proceedings, but may be conducted concurrently, with the creditors of the English Partnership having the right to look to the assets of the partners to meet any shortfall due to them. In certain limited circumstances (referred to below), creditors of the partners may be able to look to the assets of the English Partnership in such concurrent insolvency proceedings to meet any shortfall due to them.

It is likely that the other party to the ISDA Master Agreement with the English Partnership will, in determining whether it should enter into an ISDA Master Agreement with the English Partnership and how much capital should be set aside for regulatory capital purposes, look primarily to the assets of the English Partnership (as opposed to the assets of the partners themselves in their private capacity) as representing the credit standing of the English Partnership on the basis that it is easier to enforce against, or to claim in the insolvency proceedings in respect of the English Partnership (rather than enforcing against, or claiming in the insolvency proceedings in respect of, one or more of the partners). However, this will depend upon the facts and there may be circumstances in which the party to an ISDA Master Agreement with an English Partnership may wish to take into account the assets and credit rating of a particular partner (assuming that partner does not have limited liability). With the exception of a limited partner, whose liability is (in general) limited to the amount of its capital contribution to the Limited Partnership,[388] as a matter of partnership law, general partners in a Limited Partnership and each partner in a General Partnership will be liable for the debts of the English Partnership including those in respect of the ISDA Master Agreement.

The general rule is that, in the concurrent insolvency proceedings referred to above, the insolvent estates of each of the English Partnership and any of its insolvent partners are treated as separate so that the creditors of the English Partnership (treating it for these purposes as if it were a legal entity) will in the first instance be paid out of the assets of the English Partnership and the creditors of the insolvent partner will be paid out of the assets of the insolvent partner. If there is a shortfall in the assets of the English Partnership, the creditors of the English Partnership (including the party to an ISDA Master Agreement with the English Partnership) may have recourse to the assets of each insolvent partner. In the reverse scenario, if there is a shortfall in the assets of an insolvent partner, the creditors of that partner will only have recourse to the assets of the English Partnership if there is a surplus in the insolvency proceedings in respect of the English Partnership, having paid the creditors of the English Partnership in full.

In the case of an English Partnership which is a Limited Partnership, it is likely that the Limited Partnership will comprise:

(a) one general partner which is an English Company which is set up solely for the purposes of acting as the general partner of the Limited Partnership and which has no substantial assets; and

(b) one or more limited partners.

The liability of a limited partner to creditors of the Limited Partnership is limited to the capital advanced by the limited partner to the Limited Partnership, which is usually a nominal sum.[389]

388 See note 18 and below in respect of private fund limited partnerships.

389 In practice it is common for limited partners to only make nominal capital contributions, with any further investments made by way of interest-free loans or advances, which may be withdrawn without infringing on the prohibition on withdrawing capital.

In the case of a private fund limited partnership, each limited partner is under no obligation to contribute any capital or property to the partnership unless otherwise agreed between the partners and are not liable for the debts or obligations of the firm beyond the amount of the partnership property which is available to the general partners to meet such debts and obligations.[390] It is therefore likely that, upon insolvency proceedings in respect of the partners, there would be minimal assets to satisfy the claim, if any, of the party to the ISDA Master Agreement that has not been satisfied through the insolvency proceedings in respect of the Limited Partnership.

2.2 *Insolvency proceedings in respect of an English Partnership – jurisdiction for insolvency proceedings*

The Insolvent Partnerships Order 1994[391] (as amended, the **Insolvent Partnerships Order**) applies to any partnership that the courts of England have jurisdiction to wind up.

(a) Winding up or liquidation

Articles 7 to 10 of the Insolvent Partnerships Order deal with the jurisdiction to wind up a English Partnership in England by amending relevant sections of the Insolvency Act 1986 to the extent that those sections apply to a partnership.[392] By the applicable provision of the Insolvent Partnerships Order, the relevant provisions of the Insolvency Act 1986 are subject to the EC Insolvency Regulation. We have assumed that the COMI of the English Partnership is in England. This means that the English Partnership may be subject to a compulsory liquidation in England as a main proceeding under the EC Insolvency Regulation. Articles 7, 8, 9 and 10 of the Insolvent Partnerships Order provide that the provisions of the Insolvency Act 1986 relating to the winding up of an unregistered company shall apply to an insolvent partnership subject to the modifications made by the Insolvent Partnership Order to the liquidation procedure as it applies to insolvent partnerships.[393] An insolvent partnership cannot be wound up in England voluntarily.

Noting our assumption regarding COMI, section 221 of the Insolvency Act 1986 (as amended by the Insolvent Partnerships Order) only permits the winding up of an insolvent partnership on a creditor's petition if the firm has, or at any time had, in England and Wales either (a) a principal place of business or (b) a place of business at which business is or has been carried on in the course of which the debt (or part of the debt) arose which forms the basis of the petition for winding up of the partnership. Only the former condition applies in the case of a member's petition. In the case of a creditor's or a member's petition, a firm may not be wound up under the Insolvency Act 1986 if the business of the partnership has not been carried on in

390 Limited Partnerships Act 1907, section 4(2B).

391 SI 1994/2421.

392 The applicable article of the Insolvent Partnerships Order depends on the identity of the person presenting the relevant winding up petition and whether concurrent petitions are issued against the partnership's members. Article 7 to the Insolvent Partnerships Order sets out the jurisdiction of the courts in England to wind up an insolvent partnership as an unregistered company where the winding up petition is presented by a creditor of the partnership and no concurrent petition is presented. Articles 8, 9 and 10 of the Insolvent Partnerships Order respectively set out the jurisdiction of the courts in England to wind up an insolvent partnership as an unregistered company where the winding up petition is presented by a creditor of the partnership and concurrent petitions are presented against one or more members, where the winding up petition is presented by a member and there is no concurrent petition and where the winding up petition is presented by a member and there are concurrent petitions. Each article gives effect to a different schedule to the Insolvent Partnerships Order, each of which modifies the relevant provisions of the Insolvency Act 1986 to the extent that those sections apply to a partnership. The basis of the court's jurisdiction is the same in each case, as set out above.

393 The modifications include extending the definition of an "unregistered company" in section 220 of the Insolvency Act 1986 to include any insolvent partnership.

England and Wales at any time in the period of 3 years ending with the day on which the winding-up petition is presented.

If an English Partnership is subject to winding up proceedings in England, the English Partnership will be wound up as an unregistered company under section 221 of the Insolvency Act 1986, subject to the modifications of the relevant provisions made by the Insolvent Partnerships Order. Under section 221 of the Insolvency Act 1986, an "unregistered company" may be wound up as if (broadly speaking) it were an English Company. Pursuant to Article 18 and Schedule 10 of the Insolvent Partnerships Order, the Insolvency Rules 1986 apply "as from time to time in force and with such modifications as the context requires for the purpose of giving effect to the provisions of the [Insolvency Act 1986] which are applied by this Order".[394] Accordingly, insolvency set-off will be applied where a firm is wound up as an unregistered company, with or without concurrent petitions against one or more partners.[395]

(b) Administration and partnership voluntary arrangement

Under Article 1(2)(a) and Article 6 of the Insolvent Partnerships Order, an administration order may be made in respect of an insolvent partnership which the courts in England have jurisdiction to wind up (as to which, see the discussion above). Likewise, under Article 1(2)(a) and Article 4 of the Insolvent Partnerships Order, a voluntary arrangement may be entered into by an insolvent partnership which the courts in England have jurisdiction to wind up.

On the assumption that the COMI of the English Partnership is in England, an English Partnership may therefore be subject to administration under Article 3 of the EC Insolvency Regulation, subject to the modifications made by the Insolvent Partnerships Order to the administration procedure as it applies to insolvent partnerships. On the same assumption, an English Partnership may also be subject to a partnership voluntary arrangement under Article 3 of the EC Insolvency Regulation, subject to the modifications made by the Insolvent Partnerships Order to the voluntary arrangement procedure as it applies to insolvent partnerships.

Again, the Insolvency Rules 1986 are stated to apply to an administration or voluntary arrangement in respect of an English Partnership by virtue of Article 18 and Schedule 10 of the Insolvent Partnerships Order.[396]

2.3 *Close-out netting against an English Partnership*

We are of the view that the close-out netting provisions of the ISDA Master Agreement would be enforceable against an English Partnership in the event of its winding up or administration for the reasons we give in part III.3(3)(a) and (b) of this memorandum 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

394 Article 18 states that the subordinate legislation specified in Schedule 10 shall apply as from time to time in force and with such modifications as the context requires for the purpose of giving effect to the provisions of the Insolvency Act 1986 and of the Company Directors Disqualification Act 1986 which are applied by the Order. Schedule 10 of the Insolvent Partnerships Order has not been updated to refer expressly to the Insolvency (England and Wales) Rules 2016. However, note that the Deregulation Act 2015 and Small Business, Enterprise and Employment Act 2015 (Consequential Amendments) (Savings) Regulations (SI 2017/540) incorporate the new decision making procedures into the Insolvent Partnerships Order (see paras 2-11 of Schedule 2) and also note that the Dear IP Letter states that those Regulations make the necessary amendments to the Insolvent Partnerships Order so that it is "updated in line with both the Insolvency Act 1986 and the 2016 Rules", which clearly indicates that the Insolvency Service regards the Insolvency (England and Wales) Rules 2016 as applying to English Partnerships under the Insolvent Partnerships Order.

395 See Roderick I'Anson Banks, *Lindley & Banks on Partnership* (19th edn, Sweet & Maxwell 2010), para 27-73

396 See note 394 above.

owed by either party that became payable prior to the operation of Section 6(c)(ii) of the ISDA Master Agreement, as discussed in this memorandum) 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 Partnership for the reasons set out in part III.3(3)(a) and (b) of this memorandum in relation to an English Company.

If an English Partnership were to enter into a partnership voluntary arrangement the close-out netting provisions of the ISDA Master Agreement would be enforceable against the English Partnership 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 this memorandum.

ANNEX 18

BANK OF ENGLAND

In this Annex ~~16~~18, we set out our views on the enforceability of the close-out netting provisions of the ISDA Master Agreement 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.[~~312~~397] 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.

Part V of this memorandum addresses the enforceability of the ISDA Master Agreement in the absence of insolvency proceedings in respect of all Counterparties within scope of this memorandum.

If we are wrong and ~~that~~ an English court would wind up the Bank of England as an unregistered company, then the close-out netting provisions of the ISDA Master Agreement would in any event be enforceable against the Bank of England in such a case for the reasons given in Annex 9.

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~~. It appears that the only express statutory immunity of the Bank of England is set out in the Banking Act. Section 244 of the Banking Act provides immunity to the Bank of England in its capacity as a monetary authority ~~under section 244 of the Banking Act).~~. "Immunity" in this context means immunity from liability in damages in respect of action or inaction, such that (subject to any common law immunity) the Bank of England would not be immune from an action for payment of a debt (including a net claim in respect of the ISDA Master Agreement) or another alternative remedy, such as an injunction.

Whether the Bank of England is entitled to immunity from jurisdiction under the common law is unclear. On a restrictive interpretation, if a central bank takes part in ordinary commercial transactions, as opposed to governmental acts, the central bank does not benefit from sovereign immunity. However, while this common law principle has historically been applied by the English courts in relation to central banks of other jurisdictions, there is no certainty as to whether or how it would be applied in respect of proceedings against the Bank of England. It is unclear whether the Bank of England can waive any immunity from jurisdiction it may have. The further question arises as to whether a judgment against the Bank of England (assuming such a judgment can be obtained) can be enforced against assets of the Bank of England in the United Kingdom. It is unclear whether the Bank of England would be entitled to claim immunity from recognition or enforcement under the common law or, if it could, whether it is able to waive such immunity.

~~312~~397 See note ~~259~~313.

Of course, the above discussion of immunity does not go to whether a party has a valid net claim under the ISDA Master Agreement against the Bank of England. Immunity merely regulates the extent to which such party could enforce such a net claim.

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~~19 in relation to the United Kingdom acting through Her Majesty's Treasury. As discussed in Annex 19, political risk does not strictly affect the principles outlined above.

ANNEX ~~17~~19

THE UNITED KINGDOM ACTING THROUGH HER MAJESTY'S TREASURY

In this Annex ~~17~~19, we set out our views on the enforceability of the close-out netting provisions of the ISDA Master Agreement 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 ISDA Master Agreement 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, it is not necessary to consider the questions in part III of this memorandum in relation to the Crown acting through the Treasury.

Part V of this memorandum addresses the enforceability of the ISDA Master Agreement in the absence of insolvency proceedings in respect of all Counterparties within scope of this memorandum.

Without prejudice to the foregoing, an ISDA member contemplating entering into an ISDA Master Agreement 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.[~~313~~398]

(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

[~~313~~398] The position in relation to a foreign Sovereign would be somewhat different. Foreign Sovereign Counterparties do not fall within the scope of this memorandum.

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 between a party and the Crown acting through the Treasury.

Operating the close-out netting provisions of the ISDA Master Agreement 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, we have already confirmed that 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 referred to in part V of this memorandum.

(b) Immunity from execution

In the case of a close-out amount payable by the Crown, a further question would arise as to whether a judgment against the Crown given by an English court or a New York 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,[~~314~~399] 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.[~~315~~400]

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 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 between a party and the Crown, leaving the party with an enhanced credit exposure to the Crown while owing money to another entity, with a consequent loss of the risk-reducing benefit of close-out netting.

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

~~314~~399 Section 21(1) of the Crown Proceedings Act.

~~315~~400 See W Wade and CF Forsyth, *Administrative Law* (11th edn, OUP 2014) 530.

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 in whole or in part, including the close-out netting provisions of the ISDA Master Agreement.

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 between a party and the Crown (or a broader class of agreements of which the ISDA Master Agreement 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. 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 other 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.

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