

LCH Ltd
Aldgate House
33 Aldgate High Street
London EC3N 1EA

1 January 2021

Dear Sirs

Responses to Instructions to Counsel – Membership, Insolvency, Security, Set-off and Netting and Client Clearing (Evolution Phase III - Spain)

You have asked us to provide advice in respect of the laws of Spain ("**this jurisdiction**" or the "**Relevant Jurisdiction**") in response to certain specific questions raised in by LCH Ltd ("**LCH**") in relation to membership, insolvency, security, set-off & netting, client clearing and settlement finality and the impacts thereon resulting from the United Kingdom leaving the European Union with effect on 31 December 2020 at midnight ("**Brexit**"), and on the assumption that no agreement on the future of the relationships between the United Kingdom will be entered on or prior to the Brexit date (including as regards any transitory periods) such that on such date the United Kingdom is no longer a Member State of the European Union.

The relevant questions are set out in full in Section 4 of this letter ("**Opinion Letter**") together with the corresponding responses. Terms not otherwise defined in this Opinion Letter shall have the meaning ascribed to such terms in LCH' s Rulebook (as defined below).

1. **TERMS OF REFERENCE**

1.1 Our advice is given in respect of Clearing Members which are Spanish credit institutions or investment firms and all references to a "**Relevant Clearing Member**" in this Opinion Letter shall be construed accordingly. For these purposes:

- (a) a reference to a "Credit Institution" (*entidad de crédito*) is a reference to an undertaking incorporated in this jurisdiction and which has permission to accept deposits under Law 10/2014, of 26 June, on the organisation,

supervision and solvency of credit institutions ("**Law 10/2014**") and Royal Decree 84/2015, of 13 February; and

- (b) a reference to an "Investment Firm" is a reference to an undertaking incorporated in this jurisdiction as an "*empresa de servicios de inversión*" pursuant the Consolidated Text of Law 24/1988, of 28 July, on the securities market, approved by means of the Royal Legislative Decree 4/2015, of 23 October (the "**LMV**") and Royal Decree 217/2008, of 15 February, on investment service firms.
- 1.2 The opinions given on this Opinion Letter are applicable to all Services other than those governed by the FCM Regulations.
- 1.3 In this Opinion Letter:
- (a) a reference to "**BRRD**" is a reference to the Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms;
 - (b) a reference to a "**Client Contract**" is a reference to a Contract that has been entered into for the account of a Clearing Client;
 - (c) a reference to a "**Clearing Membership Agreement**" is a reference to a Clearing Membership Agreement (as defined in LCH's Rulebook) which is substantially in the form appended as Schedule 1 of this Opinion Letter;
 - (d) a reference to "**Collateral**" is a reference to "Collateral" as defined in the Rulebook;
 - (e) a reference to the "**Deed of Charge**" is a reference to a deed of charge entered into between a Relevant Clearing Member and the LCH in respect of all Charged Property transferred to LCH by that Relevant Clearing Member which is substantially in the form of the Deed of Charge set out in Schedule 2;
 - (f) a reference to "**EMIR**" is a reference to Regulation (EU) No 648/2012 of the European Parliament and the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (as amended);
 - (g) a reference to a "**financial collateral arrangement**" ("*acuerdo de garantía financiera*") is a reference to an arrangement defined as an "*acuerdo de garantía financiera*" in Royal Decree-Law 5/2005, of 11 March ("**RDL 5/2005**") by which the provisions of the Directive of the European Parliament and of the Council on financial collateral

arrangements (2002/47/EC) (the "**Financial Collateral Directive**") are implemented into the laws of this jurisdiction;

- (h) a reference to the "**FROB**" is a reference to the *Fondo de Reestructuración Ordenada Bancaria (FROB)*, the Spanish resolution authority (*autoridad de resolución ejecutiva*);
- (i) a reference to the "**Insolvency Law**" is a reference to the Reinstated Text of the Insolvency Law (*Ley Concursal*) approved by means of the Royal Legislative Decree 1/2020, of 5 May;
- (j) a reference to an "**Insolvency Representative**" is a reference to a liquidator, administrator, administrative receiver or analogous or equivalent official in this jurisdiction;
- (k) a reference to "**Law 6/2005**" is a reference to Law 6/2005, of 22 April, on the Reorganisation and Winding-up of Credit Institutions and Investment Firms, which has implemented in Spain the provisions of Directive 2001/24/EC of 4 April on the Reorganisation and Winding up of credit institutions, as amended (the "**CIWUD**");
- (l) a reference to "**Law 11/2015**" is a reference to Law 11/2015, of 18 June, on Recovery and Resolution of Credit Institutions and Investment Firms, which has implemented in Spain the provisions of BRRD;
- (m) a reference to the "**LCH Agreements**" is a reference to the Clearing Membership Agreement, the Deed of Charge and the Rulebook (which becomes contractually binding on a clearing member upon its execution of the Clearing Membership Agreement);
- (n) a reference to the "**Parties**" is a reference to LCH and a single Relevant Clearing Member to which this Opinion Letter applies, and a reference to a "**Party**" is a reference to either of them;
- (o) a reference to the "**Recast EU Insolvency Regulation**" is a reference to Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on Insolvency Proceedings (recast);
- (p) a reference to "**Rome I**" is a reference to Regulation (EU) No. 593/2008 of the European Parliament and the Council, dated 17 June 2008, on the law applicable to contractual obligations;
- (q) a reference to the "**Settlement Finality Law**" is a reference to Law 41/1999, of 12 November (*Ley sobre sistemas de pago y de liquidación de valores*) by which the provisions of the Directive of the European

Parliament and of the Council on settlement finality in payment and securities settlement systems (98/26/EC) (the "**Settlement Finality Directive**") are implemented into the laws of this jurisdiction;

- (r) a reference to "**SRB**" is a reference to the single resolution board established under the SRMR which will be responsible for determining whether an entity within the scope of the SRMR meets the conditions for it to be placed under resolution;
- (s) a reference to "**SRMR**" is a reference to Regulation (EU) No. 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010;
- (t) a reference to "**SFTR**" is a reference to Regulation (EU) No. 2015/2365 of the European Parliament and of the Council of 25 November 2015 on transparency of securities financing transactions and of reuse and amending Regulation (EU) No 648/2012 (as amended and including any technical standards made thereunder);
- (u) a reference to "**SSM Regulation**" is a reference to Regulation (EU) No. 1024/2013 of the European Parliament and of the Council of 15 October 2013;
- (v) a reference to a "**System**" is a reference to a system (*sistema*) within the meaning of the Settlement Finality Law; or (ii) a formal arrangement governed by the laws of a member state of the European Union which has been notified by such member state to the Commission of the European Communities as a system within the meaning of the Settlement Finality Directive;
- (w) unless the context otherwise requires, a reference to a "paragraph" is a reference to a paragraph in this advice and a reference to a "Section" is a reference to a section in this advice; and
- (x) headings are for ease of reference only and shall not affect interpretation of this advice.

2. **SCOPE OF THE OPINION**

- 2.1 For the purposes of preparing our Opinion Letter we have only reviewed the following documents:

- 2.1.1 The General Regulations, Procedures, Default Rules, Settlement Finality Regulations of LCH and the Product Specific Contract Terms and Eligibility Criteria published on LCH's website as at the date of this Opinion Letter ("**LCH's Rulebook**" or "**Rulebook**");
 - 2.1.2 the form of the Clearing Membership Agreement attached hereto as Schedule 1;
 - 2.1.3 the form of the Deed of Charge provided to us by LCH and attached hereto as Schedule 2; and
 - 2.1.4 the form of the Security Deed provided to us by LCH and attached to the Instructions.
- 2.2 [We have also reviewed a copy of the ESMA Board Decision of 4 April 2019 granting recognition to LCH Limited as a third country CCP under Chapter 4 of title III of EMIR and we have reviewed the LCH Agreements in connection with the instructions to counsel provided to us on 24 July 2018 (the "**Instructions**")].¹
- 2.3 Our advice is given only in respect of the specific questions raised by you as set out in Section 4.
- 2.4 Our advice is given only in respect of obligations: (a) arising under the LCH Agreements; and/or (b) arising under the Contracts between LCH and a Relevant Clearing Member which have been duly registered for clearing by LCH; and (c) which are legal, valid, binding and enforceable; and (d) which are "mutual" between the Parties in the sense that each Party is personally and solely liable as regards obligations owing by it and is the sole and beneficial owner of obligations owed to it².

Accordingly and without limitation, no opinion is expressed where a Relevant Clearing Member is acting as agent for another person, or is a trustee, or in respect of which a Relevant Clearing Member has a joint interest (including partnership) or in respect of which a Relevant Clearing Member's rights or obligations or any interest therein have been assigned, charged, attached, garnished or transferred (whether in whole or in part) whether unilaterally, by agreement or by operation of law or by order.

¹ To be updated.

² Circumstances in which the requisite mutuality will not be established include, without limitation, where a Party is acting as agent for another person, or is a trustee, or in respect of which a Party has a joint interest or in respect of which a Party's rights or obligations or any interest therein have been assigned, charged, attached, garnished or transferred (whether in whole or in part) whether unilaterally, by agreement or by operation of law by order.

- 2.5 This advice is given on the basis that LCH is not itself insolvent for the purposes of any insolvency law and is not subject to any insolvency proceedings.
- 2.6 This Opinion Letter relates solely to matters of Spanish law (as in force at the date hereof) and does not consider the impact of any laws (including insolvency laws) other than Spanish law, even where, under Spanish law, any foreign law falls to be applied. This Opinion Letter and the opinions given in it are governed by Spanish law and relate only to Spanish law as applied by the Spanish courts as at today's date. We express no opinion on the laws of any other jurisdiction.
- 2.7 We express no opinion, express or implied, as to:
- 2.7.1 whether any other creditor of, or claimant in respect of, the Relevant Clearing Member or its assets could assert superior title in respect of the Collateral, for example on the grounds of its prior acquisition of an interest in the Collateral, its acquisition of legal title to the Collateral or its having a fixed charge interest over the Collateral;
 - 2.7.2 the enforceability of any final sum certified as payable to LCH by a Relevant Clearing Member;
 - 2.7.3 the enforceability of the Default Rules in relation to any action which LCH may seek to take outside this jurisdiction;
 - 2.7.4 the validity or enforceability of any provisions of the LCH Agreements, save for those specifically referred to herein;
 - 2.7.5 any matters related to indirect clearing;
 - 2.7.6 any liability to tax as a result of or in connection with the Services, or the tax treatment of any Contracts, or the tax position of any party thereto;
 - 2.7.7 any matters of fact (including any calculations or mathematic methods or formulae, any economic or financial information or figure as well as the adequacy or the relevance of any orders of priority for payments) or the reasonableness of any statements of opinion or intention expressed in relation to any Service, including any facts, events or circumstances arising as a result of the execution of any related documents by the Parties or the performance of the Parties' obligations deriving therefrom;
 - 2.7.8 any prudential treatment of any Clearing Member's exposure to LCH (or any part thereof);

- 2.7.9 the compliance of the LCH Agreements with the provisions of EMIR and /or SFTR or the consequences of compliance or non-compliance with any applicable provisions of EMIR and/or SFTR; and
- 2.7.10 the impact on the opinions expressed in this Opinion Letter of the European Regulation proposed by the European Commission on 28 November 2016 to establish a framework for the recovery and resolution of central counterparties³.
- 2.8 This Opinion Letter is given as of 31 December (midnight London time) 2020.
- 2.9 In this Opinion Letter, some Spanish legal concepts are expressed in English and not in Spanish. The concepts concerned may not be identical to those described by the English terminology employed. Those concepts accordingly have the meaning that Spanish law gives them, irrespective of whether they are accompanied by their translation.

3. **ASSUMPTIONS**

3.1 **Assumptions relating to both Parties**

We have assumed the following with regard to each Party:

- 3.1.1 that each Party is duly incorporated and has the capacity (corporate, regulatory or otherwise), power and authority under all applicable laws to enter into the LCH Agreements and each Contract and to perform its obligations under the LCH Agreements and each Contract and that each Party has taken all necessary steps to enter into, execute, deliver, be bound by and perform the LCH Agreements and each Contract, and that such steps have not been revoked or superseded;
- 3.1.2 that each Party acts in accordance with the powers conferred by the LCH Agreements; and that (save in relation to any non-performance leading to the taking of action by LCH under the Default Rules) each Party performs its obligations under the LCH Agreements and each Contract in accordance with their respective terms;
- 3.1.3 that each Party has duly and properly executed the LCH Agreements and that each LCH Agreement is executed by the relevant Parties thereto in substantially the same form as the LCH Agreement reviewed by us as described in paragraph 2.1 above;

³ Proposal for a regulation of the European Parliament and of the Council on a framework for the recovery and resolution of central counterparties (COM(2016) 856 final), 28 November 2016).

- 3.1.4 that other than in relation to our opinion in paragraph 4.1 below, each Party has obtained, complied with the terms of and maintained all authorisations, approvals, licences and consents and has otherwise complied with all applicable laws and regulations required to enable it lawfully to enter into and perform its obligations under the LCH Agreements and each of the Contracts and to ensure the legality, validity, enforceability and admissibility in evidence of the LCH Agreements and each of the Contracts in this jurisdiction;
- 3.1.5 that the LCH Agreements and each Contract have been entered into, and each of the transactions referred to therein are carried out, by each of the parties thereto in good faith, for the benefit of each of them respectively, on arms' length commercial terms and for the purpose of carrying on, and by way of, their respective businesses;
- 3.1.6 that the execution and performance of the LCH Agreements and each Contract are in each Party's corporate interest;
- 3.1.7 that any determination due to be made by a Party in accordance with the LCH Agreements will be made in a commercially reasonable manner;
- 3.1.8 that all obligations arising under the LCH Agreements and each Contract can only be settled through a payment in cash or a delivery of financial instruments;
- 3.1.9 that there are not any other agreements, instruments or arrangements between the Parties which modify or supersede the terms of the LCH Agreements; and
- 3.1.10 that none of the Parties is entitled to claim in relation to itself or its assets immunity from suit, attachment, execution or other legal process;

3.2 Assumptions relating to LCH

We have assumed the following with regard to LCH:

- 3.2.1 that, currently, for the purposes of the Settlement Finality Directive, the Clearing Services operated by LCH have been duly designated by the United Kingdom and notified to the European Commission as a System. After Brexit, LCH will no longer be a System and will, therefore, lose the protection offered by the Finality Settlement Directive;
- 3.2.2 that, post Brexit:

- (a) the United Kingdom incorporates a regime which is exactly equivalent to the current regime which implements the Financial Collateral Directive and the Settlement Finality Directive;
- (b) the Deed of Charge and the Security Deed constitute valid and enforceable financial collateral arrangements under English law and benefit from the provisions of the UK legislation having implemented the Financial Collateral Directive in its current state on the date of this Opinion Letter;
- (c) LCH will not act as central counterparty in respect of transactions executed on a Spanish regulated market or multilateral trading facility; and;
- (d) LCH will neither actively solicit Spanish clients nor carry out marketing efforts in Spain.

3.3 Assumptions relating to the Clearing Member

We have assumed the following with regard to the Clearing Member:

- 3.3.1 that the LCH Agreements and each Contract are entered into, and any payment, delivery, or transfer of Collateral is effected, prior to the Clearing Member:
 - (a) being subject to any Reorganisation Measure (as defined below);
 - (b) being subject to any Insolvency Proceedings (as defined below);
or
 - (c) being unable, or having admitted its inability, to pay its debts as they fall due within the meaning of Article 2 of the Insolvency Law.

3.4 Assumptions relating to the Collateral

We have assumed the following with respect to the Collateral:

- 3.4.1 that each Relevant Clearing Member has the capacity, power and authority to create the security constituted by the Deed of Charge;
- 3.4.2 that each Party, when posting Collateral, has full legal title to such Collateral at such time, free and clear of any lien, claim, charge or encumbrance or any other interest of the posting party or of any third person and that there are no rights of third parties in respect of the assets comprising the Collateral nor any other impediments which would in any

way affect the transfer of the Collateral as contemplated by the LCH Agreements;

- 3.4.3 that all Collateral transferred is freely deliverable as collateral and capable of being subject to the security interest provided for in the Deed of Charge and all acts or things required by the laws of any jurisdiction to be done to ensure the validity and enforceability of such security interest will have been effectively carried out;
- 3.4.4 that any transferred Collateral will exclusively consist of either "cash" or "book-entry securities collateral" within the meaning of Article 2.1 of the Financial Collateral Directive and that both any cash bank accounts and any "securities accounts" to which such Collateral is transferred are located in the United Kingdom;
- 3.4.5 that, at any time, LCH, acting as chargee under the Deed of Charge, maintains continued possession and control over the Charged Property;
- 3.4.6 that the provision of Collateral to LCH can be evidenced in writing on paper or by electronic means through any other durable medium and that such evidencing permits the identification of the Collateral as such (provided that, for this purpose, it is sufficient to prove that the Collateral taking the form of book-entry securities has been credited to, or forms a credit in, the relevant account and that the cash Collateral has been credited to, or forms a credit in, a designated account); and
- 3.4.7 that any enforcement of the Collateral will be made on normal market terms (*conditions normales de mercado*).

3.5 Assumptions relating to foreign laws

We have assumed:

- 3.5.1 that under the laws of England to which they are expressed to be subject and under all other relevant laws (other than those of this jurisdiction):
 - (i) the LCH Agreements and each Contract constitute and will at all times constitute the valid and legally binding obligations of all parties thereto (including the Relevant Clearing Member) enforceable against them in accordance with their respective terms;
 - (ii) that the Deed of Charge is effective to create a valid security interest in favour of LCH over the Charged Property that is purported to be created thereby, as the case may be;

(iii) the choice of English law as the governing law of the LCH Agreements is a valid and binding selection;

3.5.2 that all acts, conditions or things required to be fulfilled, performed or effected in connection with the LCH Agreements under the laws of any jurisdiction other than Spain have been duly fulfilled, performed and effected; and

3.5.3 that the contractual arrangements and obligations established pursuant to and by the LCH Agreements and each Contract are not capable of being avoided for any reason other than as mentioned in paragraphs 4.2.4 or 4.4 below.

4. **ADVICE**

On the basis of the foregoing terms of reference and assumptions and subject to the reservations set out in Section 6 below, we make the following statements of opinion. These statements of opinion are summary conclusions on specific questions which you have raised.

For the avoidance of doubt, we consider Part 7 of the English Companies Act 1989 ("**Part 7**") in connection with Article 726 of the Insolvency Law to constitute an Exempting Client Clearing Rule and consequently, in accordance with the Instructions, we have not opined on the Security Deed.

4.1 **MEMBERSHIP**

4.1.1 *Are there any statutory limitations on the capacity of, or specific regulatory requirements associated with, any Relevant Clearing Member entering into, and performing its obligations under, the LCH Agreements?*

On the assumption that the Relevant Clearing Member is duly authorised to execute orders on behalf of clients and to deal on own account in respect of financial instruments as part of its license as Credit Institution or Investment Firm, there are no specific statutory limitations or regulatory requirements which would limit the capacity of an appropriately authorised Relevant Clearing Member to enter into the LCH Agreements for the purpose of providing clearing services, except that there is room to argue that being a clearing member of a foreign central counterparty amounts to the provision of investment services (namely, executing orders on behalf of clients and/or dealing on own account in respect of financial instruments) in the jurisdiction where such central counterparty is incorporated. In turn:

- (i) pursuant to Article 11.2 of Law 10 /2014, in order for any Credit Institution to provide investment services in a non-EU jurisdiction on a cross-border basis, it must provide prior notice to the Bank of Spain (in practice, such "notice" is subject to the Bank of Spain rising no objections); and
 - (ii) pursuant to Article 172.1 of the LMV, in order for any Investment Firm to provide investment services in a non-EU jurisdiction on a cross-border basis, it must obtain prior authorization by the *Comisión Nacional del Mercado de Valores* ("CNMV") (the Spanish securities regulator).
- 4.1.2 ***Would LCH be deemed to be domiciled, resident or carrying on business in the Relevant Jurisdiction by virtue of providing Clearing Services to a Relevant Clearing Member? If so, would LCH be required to obtain any additional licences or additional registrations before providing clearing services to a Relevant Clearing Member or are there any special local arrangements for the recognition of overseas clearing houses in these circumstances?***

Currently, on the basis of Article 14(2) of EMIR, which is directly applicable in Spain, clearing houses duly authorised in accordance with article 17 of EMIR, which we understand is currently the case of LCH, can provide clearing services to Spanish clearing members without being required to be licensed in Spain.

After Brexit, LCH will be authorised to provide clearing services to clearing members in Spain without being required to be licensed in Spain as it has become a recognised central counterparty pursuant to the recognition procedure set out in article 25(1) of EMIR. No further licensing requirements other than the recognition procedure provided for by Article 25 of EMIR will be required under Spanish law for the purposes of providing clearing services to Spanish Relevant Clearing Members.

4.2 **INSOLVENCY, SECURITY, SET-OFF AND NETTING**

- 4.2.1 ***Please identify the different types of Insolvency Proceedings and Reorganisation Measures. Would any of these not be covered by those events entitling LCH to liquidate, transfer or otherwise deal with Contracts as provided for in Rule 3 or Rule 5 of the Default Rules? Are any other events or procedures not envisaged in Rule 3 or Rule 5 of the Default Rules relevant?***

The only bankruptcy, composition, rehabilitation or other insolvency or reorganisation procedures to which a Credit Institution or an Investment Firm could be subject under the laws of this jurisdiction, and which are relevant for the purposes of this opinion letter, are as follows:

- (i) *concurso* (bankruptcy proceedings for individuals and companies) under Law 6/2005 and the Insolvency Law ("**Bankruptcy Proceedings**");
- (ii) *homologación de acuerdos de refinanciación* (schemes of arrangements entered into by the debtor and creditors holding at least 51% of the financial indebtedness of the debtor and approved by the Courts) under Articles 598 *et seq.* of the Insolvency Law ("**Refinancing Proceedings**");
- (iii) *procedimiento de acuerdos extrajudiciales de pago* under Articles 631 *et seq.* of the Insolvency Law ("**Composition Proceedings**"⁴ and, together with Bankruptcy Proceedings and Refinancing Proceedings, the "**Insolvency Proceedings**"); and
- (iv) recovery and resolution proceedings under Law 11/2015 ("**Reorganisation Measures**").

It is worth noting that:

- (i) Law 10/2014 provides for a specific proceeding for the so-called "intervention" (*intervención*) of Credit Institutions. However, "intervention" by itself is only aimed to the replacement of the Board of Directors of the relevant Credit Institution by new directors appointed by the Bank of Spain or to the appointment by the Bank of Spain of an official (*interventor*) to supervise and approve the operation of the relevant Credit Institution but they should not affect themselves the rights and remedies of its creditors (including any close-out netting or set-off rights). Accordingly, "intervention" itself is not characterised for the purposes of this Opinion Letter as an Insolvency Proceeding or a Reorganisation Measure;
- (ii) the LMV provides for a specific proceeding for the so-called "intervention in the winding-up" (*intervención administrativa*) of Investment Firms. However, this proceeding should not affect itself the rights and remedies of the creditors of the relevant Investment Firm (including any close-out netting or set-off rights). Accordingly, "intervention in the winding-up" itself is not characterised for the purposes of this Opinion Letter as an Insolvency Proceeding or a Reorganisation Measure;
- (iii) Law 11/2015 and, therefore, Reorganisation Measures do not apply to Investment Firms which are not subject to the initial capital requirement of EUR 730,000 set forth in Article 28.2 of Directive 2013/36/EU or

⁴ Please note that Composition Proceedings are only available where the relevant debtor has less than 50 creditors or assets and liabilities lower than EUR 5 million

which: (i) provide only one or more of the following investment services: the reception and transmission of investors' orders for financial instruments, the execution of investors' orders for financial instruments, the management of individual portfolios of investments in financial instruments and investment advice, (ii) are not authorised to provide custody services and (iii) do not hold client money or securities; and

- (iv) whilst the Fifteenth Additional Provision of Law 11/2015 provides that Spanish courts shall suspend the acceptance of any filing for insolvency in respect of any institution until the Spanish resolution authorities have decided whether early intervention measures/resolution proceedings must be adopted/open in respect to such institution, there is no provision in Law 11/2015 dealing with the possibility for institutions to commence Refinancing Proceedings, but in our opinion no Refinancing Proceedings can be commenced in respect of any Credit Institution or Investment Firm to which Law 11/2015 applies (although please note that there is no case-law on this issue so that the risk that the courts of this jurisdiction might take a different view cannot be fully discarded).

In any case, please note that all statement of opinion in this Opinion Letter in respect of Bankruptcy Proceedings and Composition Proceedings will also apply to Refinancing Proceedings since these statements are based on the provisions of Article 726 of the Insolvency Law and of the RDL 5/2005, which, in our opinion (based on the First Additional Provision of Law 9/2015, pursuant to which Refinancing Proceedings amount to an "insolvency proceeding" for the purposes of the Settlement Finality Law as well as to a "reorganisation measure" for the purposes of the application of RDL 5/2005), will also apply in the context of Refinancing Proceedings.

Please see below a general review of Bankruptcy Proceedings and Reorganisation Measures.

(a) **Bankruptcy Proceeding: general overview**

Spanish bankruptcy proceedings are called "*concurso*" and regulated in the Insolvency Law, the founding principle of the Insolvency Law being the preservation (to the extent possible) of the continuation of the business and, therefore, composition between creditors and debtor being favoured.

The application for Bankruptcy Proceedings may be filed either by the debtor or by its creditors. The directors of a company are legally obliged to file for insolvency when it becomes insolvent, i.e., where it fails to meet its current outstanding obligations on a regular basis. This obligation must

be fulfilled within the two months following the date on which the debtor became, or should have become, aware of the insolvency situation. Furthermore, directors are entitled (but not required) to apply for Insolvency Proceedings to be commenced when they expect that the company will shortly be insolvent.

Once (and if) the application has been accepted by the relevant court, it will issue an order declaring the insolvency of the company. Such order shall also specify:

- (i) the identity of the receiver appointed by the court; and
- (ii) the scope of the restrictions imposed on the debtor. The general rule is that, in the case of voluntary Bankruptcy Proceedings, the receiver supervises the company's activities, authorising (or refusing to authorise) any payment or transaction. In the case of compulsory Bankruptcy Proceedings, the debtor will cease to manage its estate and the court receiver will take control of the company being in charge of all further decisions.

Once the insolvency has been formally declared, the first stage of the proceeding will consist in the identification and classification of all of the creditors by the court receiver.

The second stage may lead either to (a) a composition between the debtor and its creditors or (b) the liquidation of the debtor's assets:

- (a) a composition (*convenio*) involving a moratorium and/or a partial reduction of debts may be entered into between the debtor and the Creditors Meeting. The majority required for approval of a composition is 50% of ordinary claims for compositions involving a debt reduction of 50% (or less) or a moratorium of 5 years (or less) and 65% otherwise (i.e., any higher reduction or longer moratorium).

The composition is not effective until approved by the court, which can only refuse such approval where the composition has been unduly approved by the Creditors Meeting (for instance, because of a wrong calculation of the relevant majority) or it is proven that the debtor will not be able to comply with the arrangement; and

- (b) if no composition is reached, the company will be wound-up and the court receiver shall liquidate the debtor's assets by selling them

in order to distribute the money obtained among the creditors according to their ranking.

(b) **Reorganisation Measures: general overview**

The BRRD has created a new framework for the resolution of failing credit institutions and investment firms across the European Union. As this was introduced in the form of a European Union directive, it was necessary for the BRRD to be implemented into national law; in Spain this was achieved pursuant to Law 11/2015. The rules that were introduced by Law 11/2015 apply to a Relevant Clearing Member that is a Credit Institution or, subject to the abovementioned exemption, an Investment Firm. They contain provisions which, subject to certain limits and conditions, affect the rights of a counterparty to terminate or designate an event of default under a contract, to exercise netting or set-off rights, or to enforce security.

In addition to the BRRD, the SRMR establishes uniform rules and procedures for the resolution of those credit institutions and certain investment firms which are established in member states of the European Union participating in the "single supervisory mechanism"⁵ established under the SSM Regulation (the "SSM") (that is, member states within the Eurozone) and groups of companies containing such a credit institution or investment firm. Since the SRMR is a European Union regulation, it was not necessary to implement this into national law.

Credit Institutions regarded as being "significant" (within the meaning given to such term in Article 6 of the SSM Regulation) will be subject to the SRM in the SRMR. Accordingly, the decision to open a resolution proceeding under the BRRD will be made by the SRB (instead of the relevant national authorities) in the first place, whilst the implementation of measures deriving therefrom will be within the responsibility of the FROB under the aegis of the SRB.

Would any of these not be covered by those events entitling LCH to liquidate, transfer or otherwise deal with Contracts as provided for in Rule 3 or Rule 5 of the Default Rules? Are any other events or procedures not envisaged in Rule 3 or Rule 5 of the Default Rules relevant?

⁵ As defined in Article 2(9) of the SSM Regulation.

Although this is a matter to be determined under English law, we believe that the events specified in Rule 5 of the Default Rules adequately refer to Insolvency Proceedings and Reorganisation Measures. Please note, however, that:

- (i) the inclusion of Reorganisation Measures in Rule 5 may well depend on whether the relevant resolution authorities qualify or not as a "Regulatory Body" as this term is used in Rule 5(e) (this being a matter of interpretation of the Rulebook which is governed by English law); and
- (ii) we cannot exclude that actions in the context of Refinancing Proceedings can be taken before Rule 5 is triggered. However, those actions may still be interpreted as a hint that the Relevant Clearing Member is "unable, or to be likely to become unable, to meet its obligations in respect of one or more Contracts" under Rule 3 (this being an issue to be determined under English law as the law governing the Rulebook).

4.2.2 ***Would the Deed of Charge be effective in the context of Insolvency Proceedings or Reorganisation Measures in respect of a Relevant Clearing Member? Is there anything that would prevent LCH from enforcing its rights under the Deed of Charge? Would LCH be required to take any particular steps or abide by any particular procedures for the purposes of enforcing against collateral provided to it by a Relevant Clearing Member under the Deed of Charge? Would the Deed of Charge constitute a financial collateral arrangement (or equivalent) in your jurisdiction?***

Pursuant to the Spanish conflict of law rules:

- (a) the purely contractual and non-*in rem* aspects of any security interest arrangements (including the Deed of Charge) shall be governed by the law chosen by the parties to this effect in accordance with, and subject to the limitations set forth in, Rome I; and
- (b) any *in rem* aspects the validity and enforceability of any security interest shall be governed by the *lex rei sitae* (i.e., English law as the law of the jurisdiction where the relevant Collateral is located). Those *in rem* aspects are as follows:
 - (i) the legal nature and proprietary effects of the security interest;
 - (ii) the requirements for perfecting a security interest and more generally the completion of the steps necessary to render such an arrangement and provision effective against third parties;

- (iii) whether a person's title to or interest in the relevant collateral assets is overridden by or subordinated to a competing title or interest, or a good faith acquisition has occurred; and
- (iv) the steps required for the realization of the collateral assets following the occurrence of an enforcement event.

Therefore, the Spanish law would recognize the choice of English law to govern both contractual and *in rem* issues of the Deed of Charge (to the extent that, as assumed, the relevant Collateral is located in England). In this respect, please note that, pursuant to the Spanish conflict of law rules, book entry securities collateral shall be deemed to be located in the country in which the relevant account is maintained.

Because the "relevant account" is maintained in England, no acts and conditions need to be done or fulfilled under the laws of this jurisdiction in order to ensure the recognition, effectiveness and perfection of LCH's security interest in the Charged Property or to enable LCH to enforce that security interest in accordance with the Deed of Charge.

Insolvency Proceedings

Article 723.1 of the Insolvency Law provides that "*the effects of the adjudication of bankruptcy of a Spanish debtor on the rights in rem of creditors or third parties in respect of tangible or intangible, moveable or immovable assets - both specific assets and collections of indefinite assets as a whole which change from time to time - belonging to the Spanish debtor which are situated within the territory of other state at the time of the adjudication of the bankruptcy **shall be exclusively governed by the laws of such other state**". Please note that the scope of this provision is not limited to collateral located in other Member States.*

Accordingly, enforcement of the security interest created under the Deed of Charge over Collateral located in England will be exclusively governed by English law (even where the Relevant Clearing Member is subject to an Insolvency Proceeding in Spain).

Furthermore, pursuant to Article 15.4 of RDL 5/2005 (consistently with Article 4.5 of the Financial Collateral Directive⁶) provides that "*financial collateral arrangements shall not be limited, restricted or affected howsoever by the opening of an insolvency proceeding or reorganization measure and shall be immediately*

⁶ This Article provides that "*Member States shall ensure that a financial collateral arrangement can take effect in accordance with its terms notwithstanding the commencement or continuation of winding-up proceedings or reorganisation measures in respect of the collateral provider or collateral taker*".

enforceable". As further discussed below and subject to the assumptions herein, we believe that the Deed of Charge constitutes a financial collateral arrangement for the purposes of the abovementioned Article 15.4

Reorganisation Measures

Law 11/2015 contains a number of provisions and tools which could generally affect the enforcement of the Deed of Charge in the context of Reorganisation Measures in respect of a Relevant Clearing Member (irrespective of whether the Deed constitutes a financial collateral arrangement or not).

Please see paragraph 4.2.3(B) below for a full discussion of this issue.

Would the Deed of Charge constitute a financial collateral arrangement (or equivalent) in your jurisdiction?

In order for any collateral arrangement to qualify as a "financial collateral arrangement" for the purposes of RDL 5/2005, it is required to satisfy the following requirements:

- (a) that either of the parties thereto is an entity of one of the entity types referred to in the list set out in Article 4 of RDL 5/2005, which list includes credit institutions, investment firms and central counterparties (irrespective of their jurisdiction of incorporation).

As LCH is a central counterparty, the Deed of Charge satisfies this requirement;

- (b) that the collateral is either: (i) cash, (ii) negotiable securities ("*valores negociables*") or other financial instruments as defined in Law 24/1988, of 28 July, on the securities market, or (iii) certain loan claims; and
- (c) that the relevant Collateral is in the "possession" or "control" (as such terms are used in the RDL 5/2005) of the collateral taker.

RDL 5/2005 is silent on the meaning of "*possession*" and "*control*", which concepts must be interpreted in light of the Financial Collateral Directive (and relevant case-law, including, in particular, the judgment of the Court of Justice of the European Union 10 November 2016 (Case C-156/15⁷)).

⁷ This judgment, in respect of monies held in an ordinary bank account, in part addressed the issues of "*possession*" and "*control*". The Court indicated that the collateral taker may be regarded as having acquired 'possession or control' of the monies credited to the account only if the collateral provider is prevented from disposing of them.

We have been asked to assume that the Deed of Charge constitutes a financial collateral arrangement under English law. Accordingly, since the abovementioned case-law is also binding on the United Kingdom, we assume that the Deed of Charge satisfies the "control" requirement.

Based on the assumptions above, the Deed of Charge would constitute a financial collateral arrangement for Spanish law purposes.

4.2.3 ***Would LCH have the right to take the actions provided for under the Default Rules (including exercising rights to deal with Contracts under Rule 6 and rights of set-off under Rule 8 but not at this stage considering those actions specifically provided for in the Client Clearing Annex to the Default Rules) in the event that a Relevant Clearing Member was subject to Insolvency Proceedings or Reorganisation Measures? Is it necessary or recommended that LCH should specify that certain Insolvency Proceedings and/or Reorganisation Measures will constitute an Automatic Early Termination Event in accordance with Rule 3 of the Default Rules?***

(A) *Insolvency Proceedings*

As a general rule, both insolvency close-out netting and post-insolvency set-off are prohibited by the Insolvency Law⁸.

However, the second paragraph of Article 726 of the Insolvency Law provides that "*without prejudice to Article 201⁹, the effects of insolvency proceedings on the rights and obligations of the parties to a payment or settlement system or to a financial market shall be governed solely by the law of the jurisdiction applicable to that system or market*".

Therefore, the second paragraph of Article 726 contains the same conflict of laws rule as that in Article 15.1 of the Settlement Finality Law and in Article 8 of the

⁸ Pursuant to Article 158 of the Insolvency Law, bilateral agreements which are yet to be performed, in whole or in part, by both parties cannot be terminated by the solvent party upon the insolvency of the other party, it being for the receivers of the insolvent party to decide on the termination or continuation of such agreements. Furthermore, Article 153 of the Insolvency Law provides that no set-off can take place in relation to claims owed to and by an insolvent party unless the requirements in order for set-off to operate have been met prior to the adjudication of the bankruptcy (unless the relevant claims arise from the same legal relationship). Accordingly, as a general rule, no creditor of a Spanish party is entitled to exercise any rights of acceleration or set-off once that such Spanish party has become bankrupt.

⁹ As discussed in paragraph 4.2.2. above, pursuant to Article 723.1 (broadly equivalent to Article 8 of the Recast EU Insolvency Regulation but geographically wider), third parties' rights *in rem* on any assets will be solely governed by the law of the jurisdiction where such assets are located.

Settlement Finality Directive, except that it also applies in relation to systems in **any** jurisdictions (including those third countries systems which are not designated Systems under the Settlement Finality Directive).

Accordingly, after Brexit, the second paragraph of Article 726 will still apply to the Relevant Clearing Members of LCH, so that the effects of Insolvency Proceedings on the rights and obligations of an insolvent Relevant Clearing Member and LCH will continue to be governed by English law.

Therefore, in our opinion, whether LCH would have the right to take the actions provided for by the Default Rules (including exercising rights to deal with Contracts under Rule 6 and rights of set-off under Rule 8) in the event that a Relevant Clearing Member is subject to Insolvency Proceedings is an issue which pursuant to the laws of this jurisdiction must be determined under English law as the law governing the LCH Agreements.

(B) Reorganisation Measures

Law 11/2015 contains a number of provisions and tools which could generally affect the enforceability and operation of the Default Rules, although, as discussed below, a number of those provisions and tools are not applicable in relation to central counterparties.

These provisions are as follows:

(1) Bail-in

Law 11/2015 confers the FROB certain write-down or conversion powers in respect of the liabilities of a failing entity (the "**Bail-in Tool**").

Article 42 of Law 11/2015 (in line with Article 44 BRRD) provides for several exclusions from the scope of the Bail-in Tool of certain liabilities which notably include (subject to other conditions set forth in Law 11/2015): (i) secured liabilities and (ii) liabilities with an initial maturity of less than seven days owed to Systems or system operators designated according to the Settlement Finality Directive or their participants and arising from the participation in such a System. After Brexit, LCH will lose the benefit of the protection set out in item (ii) above.

As regards derivative exposures, exercise of the Bail-in Tool must follow close-out – that is, obligations arising under derivative instruments may not be bailed in until the relevant derivatives have been closed out (Article

49 BRRD)¹⁰. Article 42 of Law 11/2015 excludes "secured liabilities" from bail-in¹¹ and in our view bilateral contracts between members and a central counterparty are secured liabilities for this purpose. The power to close-out derivatives (article 63(1)(k) BRRD) is only given in order to apply bail-in to the net amount (if owing by the failing institution), but if (a) there is no such amount because of full collateralisation or (b) that amount is itself secured (including secured by a financial collateral arrangement), close-out of such derivatives positions is not possible, because there is nothing to bail-in post-close-out. Therefore, if LCH as a non-EU CCP has a net exposure to a Relevant Clearing Member and such exposure is fully collateralised, there should be no possibility for the FROB to exercise its close-out and hence bail-in powers;

(2) *Exclusion of certain contractual terms in early intervention and resolution*

Pursuant to Article 66.1 of Law 11/2015 (broadly following Article 68 of the BRRD), the application of an early intervention or resolution tool or the exercise of an early intervention or resolution power shall not in itself permit anyone to exercise any right to terminate, accelerate or declare a default under any contract, provided that such Article will not affect the termination rights of a person where those rights arise by virtue of any event other than the early intervention or resolution measure or an event directly linked to such measure.

Please note that this Article 66.1 will apply to LCH both before and after Brexit;

(3) *Power to suspend certain obligations*

Pursuant to Articles 70.1 and 70.2 of Law 11/2015 (which follows Articles 69.1 and 69.2 of the BRRD), the Spanish resolution authorities have the power to suspend any payment or delivery obligations pursuant to any contract to which an institution under resolution is a party from the publication of a notice of the suspension until midnight at the end of the business day following that publication, provided that if an institution under resolution's payment or delivery obligations under a contract are suspended under Article 70.1, the payment or delivery obligations of the

¹⁰ Art 49 BRRD is expressed to apply to all derivatives, not only those entered into with EU-authorized or recognised CCP's,

¹¹ Art 2(1)(67) BRRD defines secured liabilities as follows: "any liability where the right of the creditor to payment or other form of performance is secured by a charge, pledge or lien, or collateral arrangements including liabilities arising from repurchase transactions and other title transfer collateral arrangements".

institution under resolution's counterparties under that contract shall be suspended for the same period of time.

However, Article 70.3.b) (in line with Article 69.4.b) of the BRRD) provides that Article 70.1 shall not apply to payment and delivery obligations owed to systems or operators of systems, central counterparties and central banks.

The question then arises as whether LCH will, post-Brexit, still amount to a system or a central counterparty for the purposes of such Article 70.3.b).

Whilst the term "system" is always used by Law 11/2015 and the BRRD to refer to Systems (i.e., EU systems designated by one Member State pursuant to the Settlement Finality Directive), Law 11/2015 does not define the term "*central counterparties*".

In this respect, please note as follows:

- (i) the term "central counterparties" is defined in Article 2.1(64) of the BRRD as "*a CCP as defined in point (1) of Article 2 of Regulation (EU) No 648/2012*". In turn, point (1) of Article 2 of EMIR defines a "CCP" as "*a legal person that interposes itself between the counterparties to the contracts traded on one or more financial markets, becoming the buyer to every seller and the seller to every buyer*", without making any reference to the jurisdiction of incorporation of the relevant CCP;
- (ii) as stated above, the term "CCP" in EMIR is "geographically neutral" (and not restricted to EU CCPs), it being used therein to refer to any CCP.

This does not mean, however, that the same reasoning necessarily applies to the BRRD and to Law 11/2015. Actually, the EU Commission's proposal of 23 November 2016 for the amendment of the BRRD amends Articles 63(1), 69(4)(b), 70(2) and 71(3) thereof to protect "*... central counterparties, third country central counterparties recognised by ESMA pursuant to Article 25 [EMIR] ...*", which clearly suggests that the EU Commission considers that currently these provisions only protect EU CCPs;

- (iii) notwithstanding the above, and taking into account that:
 - (a) non-EU CCPs that are recognised under Article 25 EMIR:
 - (i) are eligible for mandatory clearing of OTC derivative

contracts pursuant to article 4(3) of EMIR; and (ii) qualify as a "qualifying central counterparty" (or QCCP) under article 4(1)(88) of Regulation (EU) n° 575/2013 of the European Parliament and of the Council of 26 June 2013 ("**CRR**");

- (b) the Commission Delegated Regulation (EU) n° 2016/1401 of 23 May 2018 (adopting the draft regulatory technical standards requested by Article 49.5 BRRD on the valuation of liabilities arising from derivatives) defines "central counterparty" as any "*CCP as defined in Article 2(1) of Regulation (EU) No 648/2012, to the extent that it is either: (a) established in the Union and authorized in accordance with the procedure set out in Articles 14 to 21 of Regulation (EU) No 648/2012; [or] (b) established in a third country and recognized in accordance with the procedure set out in Article 25 of Regulation (EU) No 648/2012*"; and
- (c) as a result, concluding that non-EU CCPs that are recognised under Article 25 EMIR do not benefit from the protection from the stay provisions of the BRRD would be inconsistent with: (i) the aforementioned Commission Delegated Regulation; and (ii) from an economic standpoint, with the fact that mandatory clearing is permitted through such central counterparties and institutions subject to CRR prudential requirements are authorised to apply to them the same risk weighting as is applicable to EU CCPs,

we believe that, on balance, the better view is that non-EU CCPs that are recognised under Article 25 EMIR should be regarded as "central counterparties" for the purposes of the exemptions from the exercise of "stay powers" referred to in Articles 69.4, 70.2 and 71.3 of BRRD.

We also note that Section 70D of the English Banking Act 2009 United Kingdom has implemented the abovementioned exemptions by applying them to both EU CCPs and third country CCPs recognised under Article 25 EMIR. This clearly shows that in the view of the United Kingdom, reference to CCPS in the BRRD can be regarded as comprehensive of those non-EU CCPs that are recognised under Article 25 EMIR (but please note that we

have not checked whether the implementing laws of BRRD in any other jurisdiction have followed such approach).

Therefore, in our view, after Brexit, LCH will still benefit from the protections afforded in Article 70.3.b) of Law 11/2015.

(4) *Power to restrict the enforcement of security interests*

Pursuant to Article 70.4 of Law 11/2015 (which follows Article 70 of the BRRD) the Spanish resolution authorities have the power to restrict secured creditors of an institution under resolution from enforcing security interests in relation to any assets of that institution from the publication of the exercise of the power until midnight on the business day following that publication.

However, such Article also provides, in line with Article 70. 2 of the BRRD, that such power cannot be exercised in relation to any security interest of systems, operators of systems, central counterparties and central banks over assets pledged or provided by way of margin or collateral by the institution under resolution.

The issue then arises as whether LCH will, post-Brexit, amounts to a central counterparty for the purposes of Article 70.4. In this respect and because of the reasons set out in item (3) above, in our view, after Brexit, LCH will still benefit from the protections afforded in Article 70.4 of Law 11/2015.

(5) *Power to temporarily suspend termination rights*

Pursuant to Article 70.5 of Law 11/2015 (which follows Article 71 of the BRRD), the Spanish resolution authorities have the powers to suspend the termination rights of any counterparty under a contract with a failing institution from the publication of the exercise of the power until no later than midnight on the business day following that publication, provided that a person may exercise a termination right under a contract before the end of the suspension period if that person receives notice from the resolution authority that the rights and liabilities covered by the contract shall neither be transferred to another entity nor subject to write-down or conversion on the application of the bail-in tool (a "Notice"), and further provided that where a resolution authority exercises the above mentioned suspension power to suspend termination rights any person who has not received a Notice from the resolution authority may exercise its termination rights on the expiry of the suspension period only (a) if the rights and liabilities covered by the contract have been transferred to

another entity and on the occurrence of any continuing or subsequent enforcement event by the recipient entity; or (b) if the rights and liabilities covered by the contract remain with the failing entity and the resolution has not applied the Bail-in Tool to that contract.

However, such Article also provides, in line with Article 71.3 of the BRRD, that such power cannot be exercised in relation to systems, operators of systems, central counterparties and central banks.

The issue then arises as whether LCH will, after Brexit, amount to a central counterparty for the purposes of Article 70.5. In this respect and because of the reasons set out in item (3) above, in our view, after Brexit, LCH will still benefit from the protections afforded in Article 70.5 of Law 11/2015; and

(6) *Partial property transfer*

Pursuant to Article 67 of Law 11/2015 the Spanish resolution authorities may cause the transfer of property of a failing institution, to another person (a "**Transfer**"). A property transfer may apply to only part of a failing institution's assets and liabilities (such a Transfer being referred to as a "**partial property transfer**"). This may be the case because the property transfer expressly applies to only part of the failing institution's business or because it is ineffective in relation to foreign property so as to cause the transfer of some, but not all, of the property, rights and/or liabilities of the Relevant Clearing Member in relation to Contracts and/or the Collateral associated with such Contracts, with the result that the netting arrangements under the Default Rules of LCH would be impaired.

Notwithstanding the above, Article 67.1.b) of Law 11/2015 addresses the risk that a partial property transfer may have the effect of disassociating secured obligations from security (e.g. transferring the one but not the other), by requiring the Spanish resolution authorities to, *inter alia*, ensure that liabilities owed to or by the failing institution and security relating to them are not separated pursuant to the transfer.

Moreover, Article 67.2 of Law 11/2015 (implementing Article 80.2 of the BRRD) provides that the implementing of any early intervention measure or resolution tool shall not affect the functioning of the Systems where the FROB: (a) transfers some but not all of the assets, rights or liabilities of an institution under resolution to another entity; or (b) uses its powers under Article 64 of Law 11/2015 to cancel or amend the terms of a contract to which the institution under resolution is a party or to substitute a recipient as a party. In particular, any such transfer, cancellation or

amendment shall not affect the irrevocability, finality and enforceability of transfer orders and netting or the use of funds, securities or credit facilities as required by the Settlement Finality Law.

It is worth noting that Article 67.2 (in line with Article 80 BRRD) only deals with Systems. Therefore, we are of the opinion that Article 67.2 of Law 11/2015 (and the protections thereunder) will cease to apply to LCH after Brexit.

Notwithstanding the above, Article 67.1 of Law 11/2015 (implementing Article 76.2 of the BRRD) requires the Spanish resolution authorities to ensure that a partial property transfer does not jeopardise the effectiveness of any security arrangements, title transfer final collateral arrangements, set-off arrangements and netting agreements (it being our opinion that the LCH Agreements and the Deed of Charge shall qualify as, respectively, a netting agreement and a security arrangement for these purposes).

Is it necessary or recommended that LCH should specify that certain Insolvency Proceedings and/or Reorganisation Measures will constitute an Automatic Early Termination Event in accordance with Rule 3 of the Default Rules?

It is not recommended that LCH should specify that any Insolvency Proceedings and/or Reorganisation Measures will constitute an Automatic Early Termination Event, since Parties cannot contract out of the Insolvency Law and/or Law 11/2015.

4.2.4 ***Is there a "suspect period" prior to Insolvency Proceedings and/or Reorganisation Measures where Contracts with a Relevant Clearing Member could be avoided or challenged and, if so, what are the grounds? What are the risks for LCH in entering into Contracts and in taking collateral in respect of those Contracts during such a period? Are any special protections or exemptions for the relevant arrangements, from avoidance or challenge, available under the law of the Relevant Jurisdiction in respect of contracts in financial markets?***

Yes.

Pursuant to Article 226 of the Insolvency Law (and other related legal provisions included in RDL 5/2005), if a declaration of insolvency is made in relation to a company, the relevant court may, on the application of the Insolvency Representatives (or, should the Insolvency Representatives have not applied for it within two (2) months following to the date of the formal request of a creditor to do so, on the application of such creditor), set aside any act which is found to be

detrimental for the insolvency estate made by the insolvent debtor within the two-year period preceding the opening of an Insolvency Proceeding (the "**Suspect Period**").

When interpreting and/or applying Article 226, consideration must be paid to the following issues:

- (i) whilst the Spanish legislation does not provide for a concept of "detrimental" to this effect nor have the Supreme Court formulated yet a helpful test for this purpose, it is clear that both transactions at an undervalue and transactions intended to constitute a fraudulent preference fall within the scope of Article 226 of the Insolvency Law;
- (ii) conversely, Article 230.1^a of the Insolvency Law prevents the insolvency courts from setting aside any acts made by the Insolvent Party within the Suspect Period in the ordinary course of its business and on normal conditions; and
- (iii) as a general rule, the burden of proving that the relevant act or transaction was prejudicial to the insolvency estate must be borne by the Insolvency Representatives or the applying creditor.

Furthermore, under Articles 1,111 and 1,291-1,299 of the Spanish Civil Code, the Spanish courts may, upon the application of any creditor, set aside a fraudulent transaction entered into by the relevant debtor within the 4-year period preceding the application.

Notwithstanding the above, please note that, in accordance with Article 730 of the Insolvency Law and Article 8.1.g) of Law 6/2005 (following, respectively, Article 16 of the Recast EU Insolvency Regulation and Article 30 of the CIWUD), no act governed by a foreign law can be set aside pursuant to any of the abovementioned Spanish legal provisions where the beneficiary of that act proves that such foreign law does not allow any means of challenging that act in the case in point. Since the Contracts are governed by English law, this means that they cannot be avoided under Article 226 of the Insolvency Law where LCH succeeds in proving that English law does not allow for such avoidance.

4.2.5 ***Is there relevant netting legislation in the Relevant Jurisdiction that, in the context of Insolvency Proceedings or Reorganisation Measures in respect of a Relevant Clearing Member, might apply as an alternative to the relevant arrangements set out in the Default Rules?***

(A) *Insolvency Proceedings*

Yes.

In relation to the close-out netting rights of LCH, please note that:

- (i) Article 8.1(e) of Law 6/2005 (which implements Article 25 of the CIWUD), provides that the effect of any insolvency proceedings on netting agreements entered into by an insolvent Credit Institution or Investment Firm will be governed by the law governing such agreement.

We believe that, on balance, the better view is that the LCH Agreements (including the General Regulations and the Default Rules) constitute a "netting agreement" for the purposes of Law 6/2005 as the provisions in Regulation 45 of the General Regulations amount to a netting agreement for the purposes of Article 8.1.e) of Law 6/2005 and the Clearing Membership Agreement incorporates *de facto* the General Regulations and the Default Rules.

Therefore, the opening of Insolvency Proceedings will not prevent the close-out netting provisions in the Rulebook from being given effect in Spain; and

- (ii) furthermore, Article 16.1 of RDL 5/2005 provides that "*the declaration of early termination, rescission, cancellation, enforcement or equivalent effect of the financial transactions entered into under a contractual netting agreement or in relation to it, shall not be limited, restricted or affected in any manner by the opening of winding-up or reorganisation measures*".

The above amounts to recognising the validity and enforceability of the early termination of transactions under a contractual netting agreement following the institution of an Insolvency Proceeding with respect to a Spanish party (without the Insolvency Representatives being entitled to challenge or object such early termination) to the extent that the relevant contractual netting agreement meets the requirements set out in RDL 5/2005 to this effect (the "**Netting Requirements**").

In this respect we are of the opinion that the Clearing Membership Agreement will satisfy the Netting Requirements to the extent that:

- (a) any of the parties thereof is an entity of one of the entity types referred to in the list set out in Article 4 of RDL 5/2005, which list includes credit institutions, investment firms and central counterparties (irrespective of their jurisdiction of incorporation).

As LCH is a central counterparty, the Clearing Membership Agreement shall satisfy this requirement;

- (b) no spot transactions (other than spot FX and spot transactions on financial instruments) have been entered into under the Clearing Membership Agreement; and
- (c) the Clearing Membership Agreement creates a single legal obligation for the purposes of RDL 5/2005, whose Article 5.1 of RDL 5/2005 requires any netting agreement to "*provide for the creation of one single legal obligation which encompasses all of the financial transactions entered into under such agreement and by virtue of which, where there is an early termination, the parties will only have the right to claim the net sum of the terminated transactions*".

In this respect, in light of Clause 1.3 of the Clearing Membership Agreement and, in particular, of Regulation 45 of the General Regulations, we are of the opinion that the Clearing Membership Agreement (including the General Regulations and the Default Rules) satisfies this requirement.

Finally, as for any set-off rights of LCH, Article 727 f the Insolvency Law and Article 8.2.c) of Law 6/2005 (equivalent to, respectively, Article 9.1 of the Recast EU Insolvency Regulation and to Article 23 of the CIWUD) provide that "*the opening of insolvency proceedings shall not affect the right of creditors to demand the set-off of their claims against the claims of the debtor, where such a set-off is permitted by the law applicable to the insolvent debtor's claim*". However, it has been largely debated whether or not the set-off protection in Article 9.1 of the Recast EU Insolvency Regulation (the source of Article 727 of the Insolvency Law) can be interpreted to encompass close-out netting. Whilst from a scholar standpoint it can be debated whether set-off and close-out netting are similar rights, the laws of this jurisdiction make a distinction between the concepts of set-off and close-out netting, close-out netting encompassing two different phases: (i) termination of the relevant transactions (close-out) and (ii) set-off of the market values of the terminated transactions. Furthermore, both Law 6/2005 and the CIWUD deal with set-off and close-out netting in different provisions. Therefore, we are of the view that, unless the European Court of Justice were to find that Article 9.1 of the Recast EU Insolvency Regulation comprises close-out netting, the Spanish courts are likely to interpret that Article 727 the Insolvency Law does not cover close-out netting as the term set-off does not encompass

the first phase of the full process of close-out netting, i.e., the termination of the relevant Contracts.

(B) *Reorganisation Measures*

Conversely, neither Article 8.1.e) of Law 6/2005 nor Article 16.1 RDL 5/2005 can apply as an alternative to the relevant arrangements set out in the Default Rules in the event of Reorganisation Measures, as:

- (i) Article 8.1.e) can only be applied "without prejudice to articles 66 and 70 of Law 11/2015" (in accordance with Article 25 of CIWUD, as amended by Article 117(3) of BRRD); and
- (ii) pursuant to the second paragraph of Article 2 of RDL 5/2005 (as amended by the Seventh Final Provision of Law 11/2015), Article 16.1 of RDL 5/2005 shall not apply to any restriction on the enforcement of any close out netting or set-off provision that is imposed by virtue of Chapters VI and VII of Law 11/2015¹².

4.2.6 ***Can a claim for a close-out amount be proved for in Insolvency Proceedings without conversion into the local currency?***

In accordance with Article 1,170.1 of the Spanish Civil Code, a debtor is bound to pay in the agreed currency unless this is legally or factually impossible, in which case it may discharge its obligation by paying the equivalent amount in the Spanish legal currency.

The above notwithstanding, Insolvency Proceedings must be conducted in Euro as Article 267 of the Insolvency Law provides that all claims will be converted into Euros at the official exchange rate on the date of adjudication of bankruptcy "*for the sole purposes of quantifying the liabilities, without such process resulting in a conversion or modification of the claim*" of the Insolvent Party. In this regard, we are of the opinion that:

- (a) the close-out amount will have further to be converted into Euro in order for it to be included in the relevant Insolvency Proceedings but only for

¹² This provision is in line with Article 1(6) of the Financial Collateral Directive, added by Article 118 of BRRD, pursuant to which "*articles 4 to 7 of this Directive shall not apply to any restriction on the enforcement of financial collateral arrangements or any restriction on the effect of a security financial collateral arrangement, any close out netting or set-off provision that is imposed by virtue of Title IV, Chapter V or VI of Directive 2014/59/EU of the European Parliament and of the Council or to any such restriction that is imposed by virtue of similar powers in the law of a Member State to facilitate the orderly resolution of any entity referred to in points (c)(iv) and (d) of paragraph 2 which is subject to safeguards at least equivalent to those set out in Title IV, Chapter VII of Directive 2014/59/EU*".

the purposes of quantification of the liabilities of the Relevant Clearing Member; and

- (b) therefore, the close-out amount will have to be paid by the Insolvency Representatives, in accordance with the legal order of priority of payments, in the currency originally specified by LCH.

There is no case-law, however, as to the way in which Article 267 must be interpreted. Therefore, we cannot fully discard the risk that the Spanish Supreme Court may not uphold our interpretation of Article 267 (even if supported by scholars and lower courts) and find that the close-out amount must be paid in Euro by using the official exchange rate on the date of adjudication of bankruptcy.

4.3 CLIENT CLEARING

Default Outside Insolvency Proceedings or Reorganisation Measures

- 4.3.1 ***If LCH were to: (i) declare a Relevant Clearing Member to be in Default in circumstances other than the commencement of Insolvency Proceedings or Reorganisation Measures in respect of that clearing member; and (ii) seek to port the Client Contracts and Account Balance of a Clearing Client to a Backup Clearing Member as a result, could the Relevant Clearing Member or any other person successfully challenge the actions of LCH and claim for the amount of the Account Balance?***

In the absence of an Insolvency Proceeding or Reorganisation Measure, the declaration of a Relevant Clearing Member to be in Default and the portability of the Client Contracts and Account Balance of a Clearing Client to a Backup Clearing Member will be exclusively governed by the LCH Agreements.

This is because, pursuant to Article 12 of Rome I, the law determined to be applicable to a contract will govern the interpretation and performance of the contract as well as the consequences of a breach of contract (including the assessment of damages and termination) and the statutory limitations on bringing suit for a breach. With respect to the LCH Agreements, this entails that the laws of England govern the contractual remedies provided to the parties by the LCH Agreements. Therefore, if these remedies are enforceable in accordance with the terms of the LCH Agreements under the laws of England, this will be recognised by the courts of Spain in accordance with, and subject to the limitations set out in, Rome I both pre-Brexit and post-Brexit.

- 4.3.2 ***If LCH were to: (i) declare a Relevant Clearing Member to be in Default in circumstances other than the commencement of Insolvency Proceedings or Reorganisation Measures in respect of that clearing***

member; and (ii) seek to return the Client Clearing Entitlement to the relevant Clearing Client or to the Defaulter for the account of such client, could the Relevant Clearing Member or any other person successfully challenge the actions of LCH and claim for the amount of the Client Clearing Entitlement?

In the absence of an Insolvency Proceeding or Reorganisation Measure, the declaration of a Relevant Clearing Member to be in Default and the return of the Client Clearing Entitlement to the relevant Clearing Client or to the Defaulter for the account of such client will be exclusively governed by the LCH Agreements.

This is because pursuant to Article 12 of Rome I, the law determined to be applicable to a contract will govern the interpretation and performance of the contract as well as the consequences of a breach of contract (including the assessment of damages and termination) and the statutory limitations on bringing suit for a breach. With respect to the LCH Agreements this entails that the laws of England govern the contractual remedies provided to the parties by the LCH Agreements. Therefore, if these remedies are enforceable in accordance with the terms of the LCH Agreements under the laws of England, this will be recognised by the courts of Spain in accordance with, and subject to the limitations set out in, Rome I both pre-Brexit and post-Brexit.

Insolvency-related Default

4.3.3 *If: (i) following the commencement of Insolvency Proceedings, a Relevant Clearing Member was designated a Defaulter (whether due to the delivery of a Default Notice or (if applicable) the occurrence of an Automatic Early Termination Event); and (ii) LCH were to seek to port the Client Contracts and Account Balance of a Clearing Client to a Backup Clearing Member as a result, could an insolvency officer appointed to the Defaulter or any other person successfully challenge the actions of LCH and claim for the amount of the Account Balance?*

Pursuant to the Default Rules, including in particular the Client Clearing Annex to the Default Rules, the Contracts of Clearing Clients may be (i) transferred to a Backup Clearing Member, together with the Account Balances (a process known as "porting"); or (ii) closed out and liquidated in conjunction with the return of the Client Clearing Entitlement to the Clearing Client (or to the Defaulter for the account of the Clearing Client).

It is important to note that **in both cases**, the Relevant Clearing Member is "deprived" of any entitlement to the collateral posted by it (in the form of either the Account Balance or the Client Clearing Entitlement) which in the case of porting is transferred to the Backup Clearing Member, whilst in the case of close-

out is returned to the Clearing Client (or to the Defaulter for the account of the Clearing Clients).

In order to prevent the return of the Client Clearing Entitlements or the operation of the porting mechanism from being challenged under anti-deprivation principles or other similar principles of insolvency law, LCH intends to rely on either:

- (i) any law, regulation or statutory provision (having the force of law) of a governmental authority, the effect of which is to protect the operation of LCH's Rulebook, including in particular the Client Clearing Annex of the Default Rules, from challenge under the insolvency laws applicable to the Relevant Clearing Member (any such provision, an "**Exempting Client Clearing Rule**"); or
- (ii) if no Exempting Client Clearing Rule would apply to a Relevant Clearing Member, the Security Deed. Clearing Members in respect of whom a suitable Exempting Client Clearing Rule is not available and who wish to offer client clearing are required to enter into a security deed in favour of each of their Clearing Clients. Under the terms of the Security Deed, the Relevant Clearing Member grants a security interest in favour of its Clearing Client over the receivable from LCH in respect of assets and positions held in an account with LCH on the relevant Clearing Client's behalf.

The Rulebook permits LCH to designate a Clearing Member as an "Exempt Clearing Member" if, in its sole determination, an Exempting Client Clearing Rule would apply to a Relevant Clearing Member upon it becoming a Defaulter¹³. If a Relevant Clearing Member were designated as an Exempt Client Clearing Member, then the operation of the Client Clearing Annex of the Default Rules should be capable of being protected from challenge under the insolvency laws of Spain, being the laws applicable to the Relevant Clearing Member upon its insolvency, and the entering into of a Security Deed would not be necessary.

We understand that in order to prevent the return of the Client Clearing Entitlements or the operation of the porting mechanism from being challenged under anti-deprivation principles or other similar principles of insolvency law, LCH intends to rely on Part 7. We understand that substantive English insolvency law (in particular Part 7) would give effect to the provisions in LCH's Rulebook entitling LCH to either port the Relevant Contracts and Account Balance of a Clearing Client to a Backup Clearing Member or to return the Client Clearing Entitlement to the relevant Clearing Client or to the Defaulter for the account of

¹³ General Regulation 11(b).

such Clearing Client, irrespective of the existence and/or enforceability of a Security Deed entered into between the Clearing Member and its Clearing Clients. Part 7 would therefore operate for English law purposes as an Exempting Client Clearing Rule.

In Spain Article the second paragraph of 726 of the Insolvency Law (in line with, but geographically wider than, Article 15.1 of the Settlement Finality Law and Article 8 of the Settlement Finality Directive) provides that "*in the event of insolvency proceedings being opened against a participant in a system, the rights and obligations arising from, or in connection with, the participation of that participant shall be governed solely by the law governing that system*".

We are therefore of the opinion that, in the event of Insolvency Proceedings being commenced against a Relevant Clearing Member, such that it is designated as a Defaulter (whether due to the delivery of a Default Notice or (if applicable) the occurrence of an Automatic Early Termination Event), the effect of the second paragraph of Article 726 of the Insolvency Law is that the rights and obligations arising from, or in connection with, the participation of that Relevant Clearing Member within the LCH system would be determined by the application of substantive English insolvency law, being the law governing that system (both pre-Brexit and post-Brexit, as the scope of the second paragraph of Article 726 is not limited to Systems designated under the Settlement Finality Directive but extends also to systems based in any third country). Accordingly, Part 7, which operates as an Exempting Client Clearing Rule, would apply to the Defaulter.

We are therefore also of the opinion that if LCH were to seek to port the Relevant Contracts and Account Balance of a Clearing Client to a Backup Clearing Member, neither an insolvency officer appointed in respect of the Defaulter, nor any other person, could successfully challenge the actions of LCH and claim for the amount of the Account Balance, to the extent that such challenge is not possible under substantive English insolvency law.

4.3.4 ***If: (i) following the commencement of Insolvency Proceedings, a Relevant Clearing Member was designated a Defaulter (whether due to the delivery of a Default Notice or (if applicable) the occurrence of an Automatic Early Termination Event); and (ii) LCH were to seek to return the Client Clearing Entitlement to the relevant Clearing Client or to the Defaulter for the account of such client, could an insolvency officer appointed to the Defaulter or any other person successfully challenge the actions of LCH and claim for the amount of the Client Clearing Entitlement?***

If porting does not take place, then pursuant to the Client Clearing Annex LCH shall close out the contracts and calculate the entitlement to collateral, being the "Client Clearing Entitlement", of the Defaulter in respect of each Clearing Client¹⁴. LCH will then take instruction from those Clearing Clients who are Individual Segregated Account Clients, Identified Omnibus Segregated Clearing Clients and Affiliated Omnibus Segregated Clearing Clients and either (i) pay the Client Clearing Entitlements to the Defaulter for the account of the relevant Clearing Clients or (ii) pay the Client Clearing Entitlement directly to the relevant Clearing Client (subject to execution of documentation required by LCH). In each case this applies to both Clearing Clients who are exercising their rights under a Security Deed and Clearing Clients of an Exempt Client Clearing Member, following acceleration of its "Undertaking to Pay and Deliver", as provided for in the Rulebook. In respect of all Non-Identified Omnibus Segregated Clearing Clients, an "Aggregate Omnibus Client Clearing Entitlement" will always be returned to the Defaulter for the account of the relevant Clearing Clients¹⁵.

It is questionable whether the provisions in the second paragraph of Article 726 of the Insolvency Law would also capture the mechanism of the Security Deed. However, the mechanism of the Security Deed is intended to operate only in the absence of an Exempting Client Clearing Rule and on the basis of our opinion at paragraph 4.3.3 above, an Exempting Client Clearing Rule would apply to a Relevant Clearing Member.

Accordingly, we are of the opinion that if LCH were to seek to return the Client Clearing Entitlement to the relevant Clearing Client directly, or to the Defaulter for the account of such client, then neither an insolvency officer appointed to the Defaulter nor any other person could successfully challenge the actions of LCH and claim for the amount of Client Clearing Entitlement to the extent that such challenge is not possible under substantive English insolvency law.

Reorganisation Measures

4.3.5 *If: (i) following the implementation of Reorganisation Measures, a Relevant Clearing Member was designated a Defaulter (whether due to the delivery of a Default Notice or (if applicable) the occurrence of an Automatic Early Termination Event); and (ii) LCH were to seek to port the Client Contracts and Account Balance of a Clearing Client to a Backup Clearing Member as a result, could the representative appointed to reorganise/manage the Defaulter or any other person successfully*

¹⁴ Paragraph 9, Client Clearing Annex

¹⁵ Paragraph 9.3, Client Clearing Annex.

challenge the actions of LCH and claim for the amount of the Account Balance?

As discussed in paragraph 4.2.3(B) above, Law 11/2015 contains several provisions which might affect the effectiveness of the LCH Agreements upon the taking of a Reorganisation Measure.

In particular, the operation of the Default Rules in this case might well be affected by, without limitation, a Transfer, which must not affect the outstanding agreements relating to the transferred business, assets, rights or obligations, that must remain executory (please see paragraph 4.2.3(B)(6) above), although we note that, pursuant to Article 67.1 of Law 11/2015 (which will remain applicable post-Brexit) the FROB cannot provide for a Transfer without ensuring that those liabilities owed to or by the failing institution and security relating to them are not separated pursuant to the Transfer.

4.3.6 ***If: (i) following the commencement of Reorganisation Measures, a Relevant Clearing Member was designated a Defaulter (whether due to the delivery of a Default Notice or (if applicable) the occurrence of an Automatic Early Termination Event); and (ii) LCH were to seek to return the Client Clearing Entitlement to the relevant Clearing Client or to the Defaulter for the account of such client, could the representative appointed to reorganise/manage the Defaulter or any other person successfully challenge the actions of LCH and claim for the amount of the Client Clearing Entitlement?***

As discussed in paragraph 4.2.3(B) above, Law 11/2015 contains several provisions which might affect the effectiveness of the Default Rules upon the taking of a Reorganisation Measure. In particular, the operation of the Default Rules in this case might well be affected by, without limitation, any Transfer and/or by the prohibition to exercise the termination and close-out netting rights on the sole ground of a Reorganisation Measure (please see paragraph 4.2.3(B)(2) above).

Security Deed

4.3.7 ***Would the Security Deed provide an effective security interest under the laws of the Relevant Jurisdiction over the Account Balance or Client Clearing Entitlement in favour of the relevant Clearing Client? Would the Security Deed constitute a financial collateral arrangement (or equivalent) in your jurisdiction?***

We consider the second paragraph of Article 726 of the Insolvency Law in connection with Part 7 to constitute an Exempting Client Clearing Rule and

consequently, in accordance with the Instructions, we have not provided an answer to this question.

4.3.8 *Are there any perfection steps which would need to be taken under the laws of the Relevant Jurisdiction in order for the Security Deed to be effective?*

We consider the second paragraph of Article 726 of the Insolvency Law in connection with Part 7 to constitute an Exempting Client Clearing Rule and consequently, in accordance with the Instructions, we have not provided an answer to this question.

4.3.9. *Is there any risk of a stay on the enforcement of the Security Deed in the event of Insolvency Proceedings or Reorganisation Measures being commenced in respect of a Relevant Clearing Member?*

We consider the second paragraph of Article 726 of the Insolvency Law in connection with Part 7 to constitute an Exempting Client Clearing Rule and consequently, in accordance with the Instructions, we have not provided an answer to this question.

4.4 SETTLEMENT FINALITY

4.4.1 *On the basis that LCH will no longer receive protections pursuant to the Settlement Finality Directive (or on the basis that it will not receive the protections as contemplated in Recital 7 of the Settlement Finality Directive), would the commencement of Insolvency Proceedings in respect of a Relevant Clearing Member affect finality of settlement of transfers of funds or securities (or both) from the Relevant Clearing Member to LCH? If so, please clarify from which point in time and in which circumstances finality protections in respect of such transfers would be lost. Can settlement of transfers of funds or securities (or both) be subject to challenge in your jurisdiction? What would constitute the grounds for such challenge? For example, will only post-petition transactions or transactions at an undervalue be likely to be vulnerable to challenge? In relation to such challenges, would the underlying transactions be deemed to be voided automatically or would the underlying transaction be voidable and require challenge by the insolvency officer?*

As discussed in paragraph 4.2.3(A) above, the second paragraph of Article 726 of the Insolvency Law provides that "*without prejudice to Article 201, the effects of insolvency proceedings on the rights and obligations of the parties to a payment*

or settlement system or to a financial market shall be governed solely by the law of the jurisdiction applicable to that system or market".

Accordingly, after Brexit, the second paragraph of Article 726 will still apply to the Relevant Clearing Members of LCH, so that the effects of Insolvency Proceedings on the rights and obligations of an insolvent Relevant Clearing Member and LCH will continue to be governed by English law.

However, the second paragraph of Article 726 does not include a provision similar to that set out in paragraph 2 of Article 12 of Recast EU Insolvency Regulation, pursuant to which "*any action for voidness, voidability or unenforceability which may be taken to set aside payments or transactions under the law applicable to the relevant payment system or financial market*".

The issue then arises as to whether the provisions in the Settlement Finality Law implementing the provisions in Articles 3, 4 and 5 of the Settlement Finality Directive and, in particular, those provisions dealing with the irrevocability of transfer orders (the "**settlement finality provisions**") must be regarded (or otherwise) as provisions related to the "rights and obligations of the parties" for the purposes of the application of the second paragraph of Article 726 of the Insolvency Law.

Although this issue has not been tested before the Spanish courts (there being arguments to support both positions), we believe that, on balance, the better view is that the settlement finality provisions are provisions related to "*the rights and obligations of the parties*", so that this matter will be exclusively governed by English law.

The arguments behind this conclusion are as follows:

- (i) although there is no clear guidance in Spanish legal literature on the scope of the rights and obligations of a participant that are subject to the conflict of laws rule in Article 15.1 of the Settlement Finality Law and in the second paragraph of Article 726 of the Insolvency Law, in our view, both Articles need to be interpreted widely according to their purpose to apply to all matters that derive from participating in the relevant system and the operation of the contractual arrangements governing that system;
- (ii) as pointed out in the Virgos/Schmit commentary on the EU Insolvency Regulation (which is of persuasive and not determinative authority in interpreting the EU Insolvency Regulation), the ultimate reason for the conflict of laws rule in Article 12.1 of the Recast EU Insolvency Regulation is the **preservation of certainty** of transactions carried out in a market or system and that "*for the same reason, any possible voidness,*

*voidability or unenforceability of a payment or transaction (...) which may be detrimental to all the creditors, **remains subject to the same solution***"; and

- (iii) the wording of the Settlement Finality Directive and the Settlement Finality Law suggests that both matters are intrinsically connected. Actually, there may be well an argument that the second paragraph of Article 726 of the Insolvency Law amounts to a (somewhat convoluted) implementation by Spain of the option afforded to Member States by Recital (7) of the Settlement Finality Directive (pursuant to which "Member States may apply the provisions of this Directive to *their domestic institutions which participate directly in third country systems and to collateral security provided in connection with participation in such systems*).

In light of the considerations above, we are of the opinion that the better view is that the issue as to whether the commencement of Insolvency Proceedings may affect finality of settlement of transfers of funds or securities (or both) from any Relevant Clearing Member to LCH after Brexit will be solely governed by English law.

Moreover, please note that, in the event that our views were to prove wrong (to the effect that the abovementioned issue should be governed by Spanish law):

- (i) unlike in other European jurisdictions, in Spain the declaration of insolvency has no retroactive effect as from 00.00 hours of the day of the judgement (the actual time of the judgment rather applies)¹⁶; and
- (ii) whilst, as discussed in paragraph 4.2.4 above, Article 226 of the Insolvency Law provides that the courts of Spain can set aside any acts made by an insolvent party within the two-year period preceding the declaration of the insolvency if the Insolvency Representatives can prove that such acts were "detrimental to creditors", please note that:
 - (a) pursuant to Article 8.1(g) of Law 6/2005 (implementing the CIWUD) and Article 730 of the Insolvency Law, no acts governed by a foreign law can be set aside under Article 226 of the Insolvency Law (and related legal provisions) if the beneficiary of

¹⁶ Please note, however, that pursuant to Article 106 of the Insolvency Law, any disposition of property made or agreements entered by a party subject to Insolvency Proceedings after the declaration of insolvency without the consent or the cooperation of the Insolvency Representatives or, where applicable, the insolvency court are voidable and can be nullified.

those acts proves that the laws of such foreign law do not allow any means of challenging them.

Therefore, settlement of transfers of funds or securities (or both) could not be ultimately subject to challenge under Article 226 of the Insolvency Law if LCH proves that it could not be challenged under English law;

- (b) Article 15.2 of RDL 5/2005 (implementing Article 8.2 of the Financial Collateral Directive) provides that where a financial collateral arrangement has come into existence, or financial collateral has been provided on the day of, but after the moment of the commencement of, Insolvency Proceedings, it shall be legally enforceable and binding on third parties if the collateral taker can prove that he was not aware, nor should have been aware, of the commencement of such Insolvency Proceedings; and
- (c) pursuant to Article 15.5 of RDL 5/2005 in connection with Article 226 of the Insolvency Law, the courts of this jurisdiction can only set aside any financial collateral arrangement (including payments and deliveries/transfers of collateral thereunder) made by the insolvent party within the Suspect Period if the Insolvency Representatives can prove that such acts were "fraudulent" (*en fraude de acreedores*) rather than merely "detrimental to creditors".

4.4.2 ***On the basis that LCH will no longer receive the protections pursuant to the Settlement Finality Directive (or on the basis it will not receive the protections as contemplated in Recital 7 of the Settlement Finality Directive), are there any circumstances (such as the commencement of Reorganisation Measures) which might give rise to a loss of finality protections before the commencement of Insolvency Proceedings? If so, please clarify from which point in time and in which circumstances finality protections would be lost.***

Yes. Please note that, as discussed in paragraph 4.2.3(B) above, our opinion is that:

- (i) it is prudent to assume that those protections granted by BRRD (and Law 11/2015) to systems designated under the Settlement Finality Directive (remarkably those set out in Article 80 BRRD) will be lost as and when LCH loses its Settlement Finality Directive protections (although we acknowledge that there may be arguments to support otherwise); and

- (ii) conversely the better view is that all protections afforded by BRRD (and Law 11/2015) to central counterparties will apply to third countries CCPs recognised under Article 25 of EMIR.

5. QUALIFICATIONS

5.1 Enforceability of claims

In this Opinion Letter, "enforceable" means that an obligation is of a type which the Spanish courts may enforce. It does not mean that those obligations will be enforced in all circumstances in accordance with the terms of the LCH Agreements. In particular, enforcement before the courts of Spain will in any event be subject to:

- (a) the nature of the remedies available in the Spanish courts (and nothing in this Opinion Letter must be taken as indicating that specific performance would be available as remedies for the enforcement of such obligations);
- (b) the availability of defences such as (without limitation), set-off (unless validly waived), fraud, misrepresentation, force majeure, unforeseen circumstances, undue influence, duress, error abatement and counter-claim;
- (c) enforcement in Spain of the LCH Agreements will be subject to the rules of civil procedure as applied by the Spanish courts (which require the translation of the LCH Agreements into the Spanish language);
- (d) enforcement may be limited by the general principle of good faith; Spanish courts may not grant enforcement in the event that they deem that a right has not been exercised in good faith or that it has been exercised in abuse of right ("*abuso de derecho*"). Likewise and pursuant to article 6.4 of the Spanish Civil Code, acts carried out in accordance with the terms of a legal provision whenever such acts seek a result which is forbidden by or contrary to law, shall be deemed to have been executed in circumvention of law ("*fraude de ley*") and the provisions whose application was intended to be avoided shall apply; and
- (e) enforcement of obligations of the Relevant Clearing Member under the LCH Agreements is subject to all limitations arising from bankruptcy, insolvency, liquidation, reorganisation or similar laws generally affecting the rights of creditors (provided that this qualification is not intended to qualify our statements of opinion specifically related to Insolvency Proceedings and/or Reorganisation Measures).

5.2 Rome I

When applying English law as the law governing the LCH Agreements, the courts of competent jurisdiction of Spain, if any, by virtue of Rome I:

- (i) may give effect to any overriding mandatory provisions of the law of the country where the obligations arising out of the LCH Agreements have to be or have been performed, insofar as those overriding mandatory provisions render the performance of the LCH Agreements unlawful. In considering whether to give effect to those provisions, regard shall be had to their nature and purpose and to the consequences of their application or non-application;
- (ii) will apply any overriding mandatory provisions of the law of Spain;
- (iii) may refuse to apply English law if such application is manifestly incompatible with the public policy of Spain; and
- (iv) shall have regard to the law of the country in which performance takes place in relation to the manner of performance and the steps to be taken in the event of defective performance.

Other qualifications

5.3 As a matter of Spanish law, any collateral arrangement (including transfer of title collateral arrangements) is ancillary to the relevant secured obligations in such a way that, in the event that those secured obligations are nullified, set aside or rescinded for any reason, this would entail the relevant collateral agreement being also nullified, set aside or rescinded.

5.4 If a Party is controlled by or otherwise connected with a person (or is itself) resident in, incorporated in or constituted under the laws of a country which is the subject of United Nations, European Union or Spanish sanctions implemented or effective in Spain, or is otherwise the target of any such sanctions, then the obligations of the other Party to that Party under the LCH Agreements may be unenforceable or void.

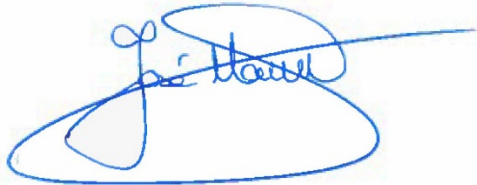
6. RELIANCE

This Opinion Letter is given for the exclusive benefit of the addressee. In issuing this Opinion Letter we do not assume any obligation to notify or inform you of any developments subsequent to its date that might render its content untrue or inaccurate in whole or in part at such time. It may not, without prior written consent, be relied on by any other person.

We consent to a copy of this Opinion Letter being made publicly available on the addressee's website and being shown to: (i) actual and prospective Clearing Members and

Clearing Clients; (ii) relevant regulators; and/or (iii) legal counsel appointed by the addressee or any person listed in (i) above to advise on matters of the laws of other jurisdictions, in each case for information purposes only and solely on the basis that we assume no responsibility to any such parties as a result or otherwise.

Yours faithfully

A handwritten signature in blue ink, appearing to read "José Manuel Cuenca". The signature is stylized with a large, sweeping loop at the end.

José Manuel Cuenca

Clifford Chance S.L.P.

SCHEDULE 1

FORM OF CLEARING MEMBERSHIP AGREEMENT

SCHEDULE 2

FORM OF DEED OF CHARGE