

Opinion in respect of the legal issues arising under New Zealand law in relation to membership, insolvency, security, set-off and netting and client clearing

New Zealand law opinion for LCH.Clearnet Limited

11 May 2016

BELL GULLY

WELLINGTON ANZ CENTRE, 171 FEATHERSTON STREET
P O BOX 1291, WELLINGTON 6140, DX SX11164, NEW ZEALAND
Tel 64 4 915 6800 Fax 64 4 915 6810

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BELL GULLY

LCH.Clearnet Limited
Aldgate House
33 Aldgate High Street
London EC3N 1EA

FROM **David Craig**
DDI 64 4 915 6839
MOBILE 64 21 674 851
EMAIL david.craig@bellgully.com
MATTER NO. 401-7354
DATE 11 May 2016

Opinion in respect of legal issues arising under New Zealand law in relation to membership, insolvency, security, set-off and netting and client clearing

You have asked us to provide advice in respect of the laws of New Zealand in response to certain specific questions raised by LCH.Clearnet Limited (**LCH**) in relation to membership, insolvency, security, set-off and netting and client clearing. We set out those questions, and our response to those questions, below.

1. Introduction

1.1 For the purposes of this opinion, we have examined and relied upon the following documents:

- (a) the instruction letter attached to LCH's e-mail to us dated 4 March 2016;
- (b) the LCH rulebook, which includes: (i) the general regulations (the **Regulations**); (ii) the default rules (the **Default Rules**); (iii) the settlement finality regulations; (iv) the procedures; and (v) the product-specific contract terms and eligibility criteria manual, in the form published on LCH's website as at the date of this opinion (collectively, the **Rulebook**);
- (c) a clearing membership agreement, in the form attached as Appendix A (the **Clearing Membership Agreement**);
- (d) a deed of charge, in the form attached as Appendix B (the **Deed of Charge**); and
- (e) a security deed, in the form attached as Appendix C (the **Security Deed**).

1.2 This opinion is given in respect of parties that are companies incorporated, or re-registered, under the Companies Act 1993 (each, a **Relevant Entity**). The term "Relevant Entity" includes banks, credit institutions, investment firms and other entities that are incorporated, or registered, under the Companies Act, but does not include:

- (a) foreign companies or entities; or
- (b) any party acting in its capacity as trustee of a fund, scheme or trust;¹ or
- (c) bodies corporate, such as local authorities or other statutory corporations, that are governed by special legislation or rules in addition to or other than the Companies Act; or

¹ We note that, under New Zealand law, superannuation funds, most managed investment schemes and other trusts are not legal entities. The relevant entity is the trustee acting in its capacity as trustee of the relevant fund, scheme or trust.

- (d) the Crown.
- 1.3 Section 2 of this opinion addresses legal issues that may arise in relation to Relevant Entities becoming clearing members of LCH (each, a **Relevant Clearing Member**) and entering into the following agreements and deeds:
 - (a) the Clearing Membership Agreement;
 - (b) the Deed of Charge; and
 - (c) the Rulebook,(the **LCH Agreements** and, together with the Security Deed, the **Documents**).
- 1.4 For the purposes of section 2 of this opinion, we assume:
 - (a) that the LCH Agreements are legal, valid, binding and enforceable under English law (as the law that governs them); and
 - (b) the compliance with all relevant perfection requirements relating to, and the effectiveness of, the collateral arrangements under the Deed of Charge under the laws of all relevant jurisdictions (other than New Zealand).
- 1.5 As instructed, we do not, in section 2 of this opinion, address issues specifically related Contracts entered into, and Collateral delivered, on behalf of Clearing Clients.
- 1.6 Section 3 of this opinion addresses legal issues that may arise in relation to a Relevant Clearing Member providing Client Clearing Services to Clearing Clients (whether those Clearing Clients are incorporated in New Zealand or in any other jurisdiction). For the purposes of section 3 of this opinion, we assume that:
 - (a) LCH will require Relevant Clearing Members to enter into a Security Deed; and
 - (b) the Security Deed is legal, valid, binding and enforceable under English law (as its governing law) and complies with all relevant perfection requirements under the laws of all relevant jurisdictions (other than New Zealand).
- 1.7 Section 4 of this opinion considers the impact on finality of settlement of transfers of funds or securities (or both) from a Relevant Clearing Member to LCH in the event of that Relevant Clearing Member entering Insolvency Proceedings or becoming subject to a Reorganisation Measure (each, as defined at 2.8(a) below).
- 1.8 Unless otherwise specified, the analysis and conclusions in this opinion apply equally to each service offered by LCH (together, the **Services**).
- 1.9 This opinion is given subject to the assumptions and qualifications set out in Schedules 1 and 2, respectively.
- 1.10 Capitalised terms used but not defined in this opinion have the meanings given to them in the Rulebook. In addition:
 - (a) **Clearing Member Contract** means the agreement between LCH and a Relevant Clearing Member comprising the Clearing Membership Agreement between them, the terms of every Relevant Contract between them, and the Rulebook; and
 - (b) **Relevant Contract** means a Contract between LCH and a Relevant Clearing Member.

2. Membership

General

2.1 ***Are there any statutory limitations on the capacity of, or specific regulatory requirements associated with, any Relevant Clearing Member entering into the LCH Agreements (including for the purpose of granting security under the Deed of Charge)?***

We have assumed that each Relevant Clearing Member is a company incorporated, or re-registered, under the Companies Act. Section 16 of the Companies Act specifies the capacity and powers of a company. Section 16(1) provides that a company has, both within and outside New Zealand:

- (a) Full capacity to carry on or undertake any business or activity, do any act, or enter into any transaction; and
- (b) For the purposes of paragraph (a)..., full rights, powers, and privileges.

Section 16(2) provides that a company's constitution may contain a provision relating to the capacity, rights, powers or privileges of that company, but only if the provision *restricts* that capacity or those rights, powers and privileges.

If a company's capacity is not restricted as permitted by section 16(2), then section 16(1) confers on that company the capacity to enter into the LCH Agreements (including for the purpose of granting security under the Deed of Charge). In other words, a constitution is not required to confer capacity on a company to enter into the LCH Agreements. However, it may restrict the company from doing so if it contains a provision to that effect.

Accordingly, there are no statutory limitations on the capacity of, or specific regulatory requirements associated with, any Relevant Entity entering into the LCH Agreements (including for the purpose of granting security under the Deed of Charge). However, a Relevant Entity's capacity may be restricted by its constitution, as permitted by section 16(2) of the Companies Act. It would be unusual, in practice, for a Relevant Entity's constitution to contain such a restriction.

2.2 ***Would LCH be deemed to be domiciled, resident or carrying on business in New Zealand by virtue of providing clearing services to a Relevant Clearing Member? If so, would LCH be required to obtain a licence or be registered 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?***

This question raises the potential application of the following regulatory regimes in New Zealand:

- Part 18 of the Companies Act, which governs overseas companies carrying on business in New Zealand;
- Part 5C of the Reserve Bank of New Zealand Act 1989 (the **Reserve Bank Act**), which provides for the designation and oversight of "settlement systems" in New Zealand;
- Part 6 of the Financial Markets Conduct Act 2013 (the **FMCA**), which provides for the licensing of certain market services; and
- other laws of more general application.

We look at each of these regimes in turn below.

(a) **Companies Act**

The Companies Act requires an “overseas company” that carries on business in New Zealand to register under Part 18 of that Act. LCH is an “overseas company” for this purpose.

Minimal activity in New Zealand can be sufficient to constitute carrying on business in New Zealand. However, the test for determining whether this threshold is met is not well established by case law, and is particularly difficult to apply in the context of activities that do not necessarily involve a physical presence in New Zealand.

Given the lack of (statutory, case law or regulator) guidance on this issue, it is difficult to quantify the level of activity in New Zealand that would take LCH over this regulatory threshold. The application of the test to LCH involves weighing up all the relevant New Zealand activities of LCH.

To strengthen the argument that LCH is *not* carrying on business in New Zealand, we suggest that, to the extent practicable, LCH should avoid the following types of activities:

- (i) establishing a physical presence in New Zealand (e.g., a New Zealand office);
- (ii) signing contracts with New Zealand clients in New Zealand;
- (iii) appointing local agents;
- (iv) sending employees to New Zealand (other than on an *ad hoc* basis); and
- (v) entering into contracts with New Zealand clients using New Zealand law as the governing law.

The more of these factors that LCH can satisfy and still effectively achieve its objectives in New Zealand, the greater the likelihood that Part 18 of the Companies Act will not apply to it. We emphasise that the application of the registration requirement is not a bright-line test and that a relatively minimal degree of activity is sufficient to trigger the obligation to register.

That said, while it is not free from doubt, it is unlikely that LCH would be regarded as carrying on business in New Zealand solely by virtue of providing the Services to a small number of Relevant Clearing Members. However, this is a factual assessment, and LCH should form an independent view.

Further, we recommend that LCH should continue to review this potential registration requirement as its New Zealand activities develop over time.

If LCH commences carrying on business in New Zealand, it will be required to register under Part 18 of the Companies Act within 10 working days of doing so. Once registered, an overseas company is required to comply with a number of continuing obligations under the Companies Act. Currently, the most onerous of these obligations is the requirement to file New Zealand GAAP audited financial statements in certain circumstances (although, there are certain exceptions to that requirement). In addition, registration under Part 18 of the Companies Act could, in turn, bring LCH within New Zealand’s anti-money laundering regime under the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (if LCH is a “reporting entity” under that Act).

(b) **Reserve Bank Act**

Part 5C of the Reserve Bank Act provides for the designation and oversight of “settlement systems” in New Zealand. The term “settlement system” is defined to include “a system or arrangement for effecting settlements² or processing settlement instructions in accordance with rules”. In our view, the clearing system operated by LCH is a “settlement system” for this purpose.

Part 5C is currently an “opt-in” regime. This means that operators of settlement systems in New Zealand have the option, but not the obligation, to apply for designation. However, the Reserve Bank of New Zealand (the **Reserve Bank**) has recently published a document³ setting out its final proposal in relation to the enhancement of the existing supervisory framework for financial markets infrastructures (**FMI**s) in New Zealand. This document proposes amendments to the existing designation regime, which would require all “systemically important” FMIs to become designated under Part 5C of the Reserve Bank Act.

In an earlier consultation document (the **Consultation Document**),⁴ the Reserve Bank indicated that it would regard an FMI as “systemically important” if “disruption within it will have the potential to trigger or transmit systemic disruptions across the financial system”.⁵ LCH is named in the Consultation Document⁶ as an operator of an FMI that could, in the RBNZ’s preliminary view, be systemically important. As such, LCH’s Swapclear system could be required to become designated in the future.

Given that possibility, we briefly outline below the process for applying for, and the consequences that flow from, designation. Other than in the section below, and where we expressly do so elsewhere in this opinion, we do not consider how LCH’s designation as a settlement system under Part 5C would affect our response to the questions we address.

² In turn, **settlement** means—

- (a) the making of a payment or the transfer of the title to, or an interest in, property—
 - (i) that is done in accordance with, or to give effect to, a settlement instruction; and
 - (ii) that is on a gross basis or that uses netting; and
 - (iii) whether by way of book entry on the accounts of a central bank or an operator of a settlement system or otherwise; or
- (b) any other act that discharges an obligation to make a payment or transfer the title to, or an interest in, property in accordance with the rules of a settlement system

³ *Summary of submissions and final policy proposals on the Consultation Paper: Oversight of Designated Financial Market Infrastructures* (December 2015): http://www.rbnz.govt.nz/regulation_and_supervision/financial-market-infrastructure-oversight/regulatory-developments/summary-of-submissions-and-final-policy-proposals-FMI-oversight-dec-2015.pdf

⁴ *Consultation Document: Oversight of Designated Financial Market Infrastructure* (April 2015): <http://www.rbnz.govt.nz/-/media/ReserveBank/Files/regulation-and-supervision/financial-market-infrastructure-oversight/oversight-of-designated-financial-market-infrastructures.pdf>

⁵ At page 5.

⁶ At page 6.

Application for designation

An application for designation under Part 5C of the Reserve Bank Act must be made to either the Reserve Bank or the Financial Markets Authority (the **FMA**), who are the joint regulators of designated settlement systems in New Zealand. Applications are assessed by the joint regulators in accordance with the procedure set out in sections 156Y–156ZA of the Reserve Bank Act.

Section 156Z of the Reserve Bank Act requires the joint regulators to take into account the following matters when considering an application for designation of a settlement system:

- (i) the purpose and scope of the settlement system;
- (ii) the rules of the settlement system;
- (iii) any laws or regulatory requirements relating to the operation of the settlement system and the extent to which the settlement system complies with those laws or regulatory requirements;
- (iv) relevant international standards concerning clearing and settlement systems, to the extent that they are relevant in the circumstances;
- (v) the capability and capacity of the operators of the settlement system;
- (vi) the financial resources of the settlement system;
- (vii) the importance of the settlement system to the financial system;
- (viii) the impact on creditors of participants in the settlement system of specifying that an operator of the settlement system is an operator to whom section 103A of the Personal Property Securities Act 1999 (the **PPSA**) applies;⁷ and
- (ix) any other matters that the joint regulators consider appropriate.

Consequences of designation

The key benefit of designation is that it provides statutory protection for “settlements” and validation of the rules under which settlements occur. In particular, “despite any enactment or rule of law to the contrary”, designation confirms:

- (i) the finality of settlements effected through the designated settlement system;⁸
- (ii) the validity and enforceability of the rules of the designated settlement system;⁹ and
- (iii) the validity and enforceability of netting under the rules of the designated settlement system, to the extent those rules provide for netting.¹⁰

⁷ Designation gives the operator of a designated settlement system a super-priority in respect of any security interest in personal property held to effect a settlement or to mitigate a loss resulting from a participant default.

⁸ Section 156R of the Reserve Bank Act.

⁹ Section 156Q(1) of the Reserve Bank Act.

¹⁰ Section 156T of the Reserve Bank Act.

The protections in Part 5C of the Reserve Bank Act are linked to the “rules” of a designated settlement system. This is a key term, which is defined in section 156M as follows:

- (a) in relation to a settlement system, means the rules of the settlement system (whether made under bylaws, agreements, procedures, contracts, or other documents) that are evidenced in writing and that provide, among other things, for—
 - (i) the basis on which settlement instructions are given or received; and
 - (ii) the basis on which settlement obligations are determined and calculated (either on a gross basis or using netting); and
 - (iii) the basis on which settlements are effected (either on a gross basis or using netting); and
 - (iv) any action to be taken if a participant in the settlement system is unable, or likely to become unable, to meet the participant’s obligations to any or all of the following:
 - (A) an operator of the settlement system;
 - (B) another participant in the settlement system;
 - (C) any other party to those rules; and
- (b) in relation to a designated settlement system, means the rules of that settlement system that are contained in documents specified in the designation under section 156N, and includes any amendments to those rules that have—
 - (i) been notified, not been disallowed, and come into effect in accordance with the processes and the time frames set out in sections 156ZB and 156ZC; or
 - (ii) been made pursuant to a variation of a designation under section 156ZD.

(c) **FMCA**

Part 6 of the FMCA requires providers of certain “market services” to be licensed by the FMA. One of those market services is “acting as a derivatives issuer in respect of a regulated offer of derivatives”. The term “derivatives issuer” is defined to mean “a person that is in the business of entering into derivatives”.¹¹ This could include LCH. Therefore LCH could be subject to Part 6 if it makes a “regulated offer” of derivatives. That should not be the case. A “regulated offer” is, in simple terms, an offer to *retail* investors. By contrast, LCH will only enter into derivatives with its clearing members, all of whom will invariably be *wholesale* investors for the purposes of the FMCA. Part 6 would not, therefore, apply.¹²

(d) **Other laws of more general application**

While not specifically relevant to the issue of whether LCH would be deemed to be domiciled, resident or carrying on business in New Zealand by virtue of providing clearing services to Relevant Clearing Members, we note that there are laws of general application that could apply to LCH as a consequence of it providing the Services to Relevant Clearing Members. These include, without limitation:

¹¹ “Derivatives” is defined broadly in section 7(4) of the FMCA, and would include “Contracts”.

¹² As an aside, if LCH were the operator of a designated settlement system, it would in any event be exempt from the licensing requirements under Part 6: section 389(1)(b) of the FMCA.

- (i) the Financial Service Providers (Registration and Dispute Resolution) Act 2008, which requires persons who have a place of business in New Zealand, and who are in the business of providing a “financial service” to clients in New Zealand, to register as a financial service provider; and
- (ii) the Financial Advisers Act 2008, which includes a regime for regulating persons who provide broking and custodial services to clients in New Zealand.¹³ A similar, but alternative, regime that applies to investor funds held by “derivatives issuers” (as to which, see (c) above) is contained in regulations 238-250 of the Financial Markets Conduct Regulation 2014 (the **FMC Regulations**).¹⁴

2.3 What type of documents should be obtained by LCH to evidence that a Relevant Clearing Member and its officers have the capacity and authority to enter into the LCH Agreements? Is LCH required to verify such evidence?

(a) Capacity

Section 17(1) of the Companies Act provides that:

No act of a company and no transfer of property to or by a company is invalid merely because the company did not have the capacity, the right, or the power to do the act or to transfer or take a transfer of the property.

The intention of this provision is to abolish the doctrine of *ultra vires* in relation to companies. However, it is not clear whether this provision would protect a party relying on section 17(1) where that other party knew, or ought to have known, of the company’s lack of capacity. Therefore, when entering into LCH Agreements with a Relevant Clearing Member, LCH may wish to request a copy of the Relevant Clearing Member’s constitution (if it has one)¹⁵ and review that constitution to ensure there are no restrictions on the Relevant Clearing Member’s capacity to enter into, and perform its obligations under, the LCH Agreements.

(b) Authority

Source of authority

Section 128(1) of the Companies Act provides that the business and affairs of a company must be managed by, or under the direction or supervision of, the board of the company (the **Board**).

The powers necessary for the Board to undertake the governance of a Relevant Clearing Member are contained in the Companies Act and the Relevant Clearing Member’s constitution (if it has one).

For matters placed outside the Board’s authority by the Companies Act (for example, entry into a transaction that is a “major transaction” under section 129 of the

¹³ We note however that, pursuant to section 77C(1)(c) of the Financial Advisers Act, there is an exemption from this regime for operators of a designated settlement system who provide broking services in accordance with the rules of that settlement system.

¹⁴ As with the Financial Advisers Act, the FMC Regulations contain a carve-out for operators of a designated settlement system.

¹⁵ Section 26 of the Companies Act provides that a company is not required to have a constitution. Section 28 of the Companies Act provides that, if a company does not have a constitution, the company, the board, each director, and each shareholder of the company have the rights, powers, duties and obligations set out in the Companies Act.

Companies Act) or the Relevant Clearing Member's constitution, the ultimate decision makers are the shareholders, who act by passing appropriate resolutions.

Section 130 of the Companies Act provides that, subject to any restrictions in the Relevant Clearing Member's constitution, the Board of the Relevant Clearing Member may delegate certain powers to other persons. Section 130(2) provides that, subject to certain limited exceptions, a Board that delegates a power under section 130(1) is responsible for the exercise of that power by the delegate as if the power had been exercised by the Board itself.

Documents or evidence LCH should obtain to determine authority

A Relevant Clearing Member acts through the person who represents it and, as such, that person acts as the agent of the Relevant Clearing Member. However, the essence of agency is authority, so that the Relevant Clearing Member (as principal) must have given permission for the agent to act on its behalf. LCH is entitled to make certain assumptions, both at common law and under the Companies Act, with respect to the authority of the relevant director, employee or agent of the Relevant Clearing Member to enter into the LCH Agreements. These assumptions are outlined below under the heading "The indoor management rule generally".

Express and implied authority

An agent may have either express or implied authority. Express authority is typically set out in a Relevant Clearing Member's constitution. Implied authority exists by virtue of the position occupied by the agent and the surrounding circumstances. In both situations, the Relevant Clearing Member will be bound by the acts of its agent within its authority. In addition, if the Relevant Clearing Member has represented that the agent has authority, then that agent will have ostensible authority and so will be able to bind the Relevant Clearing Member.

The indoor management rule generally

The Companies Act deals with the issue of authority in section 18(1). This provision states, in broad terms, that a third party (such as LCH) dealing with a Relevant Clearing Member is entitled to assume, among other things, that the Relevant Clearing Member's internal requirements (e.g., treasury and other corporate authorities) have been complied with. This statutory "indoor management rule" provides that a Relevant Clearing Member may not assert against LCH that:

- (i) the Companies Act or its constitution has not been complied with; or
- (ii) a person held out by the Relevant Clearing Member as a director, employee or agent has not been duly appointed, or does not have authority to exercise a power that such a person customarily has authority to exercise; or
- (iii) a person held out by the Relevant Clearing Member as a director, employee or agent with authority to exercise a power that such a person does not customarily have authority to exercise, does not have authority to exercise that power; or
- (iv) a document issued on behalf of a Relevant Clearing Member by a director, employee, or agent of the Relevant Clearing Member with actual or usual authority to issue the document is not valid or not genuine.

Qualification to the rule

There is an important qualification to the indoor management rule. The proviso to section 18(1) of the Companies Act provides that LCH may not rely on this protection where it "has, or ought to have, by virtue of [its] position with or relationship to the company, knowledge" that authority does not exist or that the Relevant Clearing Member's internal requirements have not been complied with.

Whether a person in LCH's position has, or ought to have, been put on notice often raises difficult issues, since so much depends on the surrounding factual circumstances.

Our experience is that a party in LCH's position often attempts to minimise the risk that it is put on notice that the relevant director, employee or agent is not authorised, by limiting its knowledge of the surrounding circumstances. This is typically dealt with by the party in LCH's position receiving a certified copy of the Relevant Clearing Member's constitution (if it has one) and:

- (i) by receiving an appropriate director's certificate;
- (ii) by receiving a legal opinion addressing the issue of authority; and/or
- (iii) by adhering to a uniform practice of never seeking underlying authorities and certificates and so assuming that the directors and management of the Relevant Clearing Member have complied with all appropriate requirements and authorities.

2.4 Are there any formalities to be complied with upon entry into of any of the LCH Agreements and, if so, what is the effect of a failure to comply with these?

(a) Execution of documents

Section 180(1) of the Companies Act provides that a contract or other enforceable obligation may be entered into by a company as follows:

- (a) an obligation which, if entered into by a natural person, would, by law, be required to be by deed, may be entered into on behalf of the company in writing signed under the name of the company by—
 - (i) 2 or more directors of the company; or
 - (ii) if there is only 1 director, by that director whose signature must be witnessed; or
 - (iii) if the constitution of the company so provides, a director, or other person or class of persons whose signature or signatures must be witnessed; or
 - (iv) 1 or more attorneys appointed by the company in accordance with section 181 [of the Companies Act];
- (b) an obligation which, if entered into by a natural person, is, by law, required to be in writing, may be entered into on behalf of the company in writing by a person acting under the company's express or implied authority;
- (c) an obligation which, if entered into by a natural person, is not, by law, required to be in writing, may be entered into on behalf of the company in writing or orally by a person acting under the company's express or implied authority.

If an LCH Agreement is required to be entered into as a deed, LCH will need to satisfy itself that the deed has been executed by the Relevant Clearing Member in accordance with section 180(1)(a) of the Companies Act. We consider the various

execution options specified in section 180(1)(a) below and the documentary evidence that LCH should request from the Relevant Clearing Member in each situation.

Execution of a deed by one or more directors of the Relevant Clearing Member

If a Relevant Clearing Member executes a deed by its director/s (i.e., in accordance with section 180(1)(a)(i), (ii) or (iii)), LCH should obtain a company extract from the Companies Office website (www.business.govt.nz/companies) on the date of signing in order to check whether each signatory is listed in those records as a director of the Relevant Clearing Member.

Execution of a deed by other persons provided in the Relevant Clearing Member's constitution

If a Relevant Clearing Member executes a deed by other person/s provided in the Relevant Clearing Member's constitution (i.e., in accordance with section 180(1)(a)(iii)), LCH should obtain a certified copy of the Relevant Clearing Member's constitution from the Relevant Clearing Member and review that constitution to ensure the requisite authority exists. Generally, the recipient of a delegated power may not delegate that power unless expressly authorised to do so under the terms of his or her authority.

Witnessing a deed

Section 180(1)(a)(ii) and (iii) provides that the signature of the director/other authorised person must be witnessed. LCH should check the executed document to ensure that the witness has executed the document in accordance with section 9(7) of the Property Law Act 2007, which provides that:

A witness—

- (a) must not be a party to the deed; and
- (b) must sign the deed; and
- (c) if signing in New Zealand, must add—
 - (i) the name of the city, town, or locality where he or she ordinarily resides; and
 - (ii) his or her occupation or description.

Execution by one or more attorneys

With regards to execution of a document by one or more attorneys of the Relevant Clearing Member, section 181(1) of the Companies Act provides that:

Subject to its constitution, a company may, by an instrument in writing executed in accordance with section 180(1)(a) [of the Companies Act], appoint a person as its attorney either generally or in relation to a specified matter.

Section 181(2) provides that an act of an attorney in accordance with the instrument binds the company.

In addition, section 20(3) of the Property Law Act provides that a person dealing with an attorney may rely on a certificate of non-revocation of the power of the attorney, in the form set out in Schedule 1 of the Property Law Act, as conclusive proof of the power of attorney as at the date of the certificate, so long as the person dealing with the attorney is acting in good faith and does not have actual notice of an event revoking the power of attorney.

On this basis, if a Relevant Clearing Member executes a document in accordance with section 181, LCH should obtain and review:

- (i) a certified copy of the Relevant Clearing Member's constitution (if it has one);
- (ii) a copy of the instrument that appoints each attorney (usually entitled a "Power of Attorney"); and
- (iii) for each attorney, a certificate of non-revocation of power of attorney in the form of Schedule 1 of the Property Law Act, signed by the attorney.

If an LCH Agreement is not required to be executed as a deed, LCH will be able to rely on section 180(1)(b) or (c) as applicable. However, as a matter of best practice, LCH may still wish to conduct some, or all, of the due diligence described above in respect of a deed in order to confirm signing authority.

What are the consequences of failing to comply with the formalities in relation to the execution of documents?

If the requirements of the Companies Act in relation to the execution of documents are not satisfied, the contract entered into with a Relevant Clearing Member may not be legally valid and binding under the laws of New Zealand.

(b) Perfection of security interests

Where New Zealand law applies

To the extent that New Zealand law governs issues of perfection of any security interest arising under the LCH Agreements,¹⁶ it may be necessary for LCH to take steps to perfect that security interest in accordance with the PPSA. We describe in Schedule 3 the various means of perfection of a security interest under the PPSA and advise that the prudent course of action is for LCH to register a financing statement to perfect its security interest in any intangible securities or general intangibles.¹⁷ However, our experience to date is that few secured parties are registering financing statements in these circumstances.

Where foreign law applies

If, under the conflict of laws rules described in Schedule 3, the laws of another jurisdiction govern issues of perfection of any security interest arising under the LCH Agreements, and LCH has obtained a valid and perfected security interest under the laws of that jurisdiction, subject to what we say below concerning section 32 of the PPSA, no action is required under the laws of New Zealand to establish, perfect, continue or enforce this security interest.

Section 32 of the PPSA provides that, if the relevant (foreign) governing law does not provide for public registration or recording of the security interest or a notice relating to it, and the collateral is not in the possession of the secured party, the security interest is subordinate to:

¹⁶ Paragraph 5 of Schedule 3 describes the circumstances in which New Zealand law will govern issues of perfection of a security interest arising under the LCH Agreements.

¹⁷ Although we note the 'super -priority' that is accorded to operators of designated settlements systems (without them having to take further action, such as registering a financing statement in respect of their security interest): see footnote 7.

- (i) an interest in an account receivable (such as cash) that is payable in New Zealand; or
- (ii) an interest in an investment security acquired when the collateral was situated in New Zealand,

unless that security interest is perfected under the PPSA before the interest in paragraph (a) or (b) arises.

What are the consequences of failure to perfect?

The usual consequence of failing to perfect a security interest, in situations where New Zealand law governs issues of perfection of that security interest, is that the secured party may lose priority as against other creditors of the grantor. However, we note that there are methods aside from perfection that allow a secured party in LCH's position to gain priority over all other security interests (as discussed further in Schedule 3).

2.5 ***Would the courts of New Zealand uphold the contractual choice of law and jurisdiction set out in Regulation 51?***

(a) **Choice of law**

The parties' contractual choice of law under Regulation 51 of the Regulations will be recognised in New Zealand if:

- (i) the choice of law is legal and is freely and genuinely made in good faith;
- (ii) there is no reason for avoiding the choice of law on the ground of New Zealand public policy; and
- (iii) the relevant matter to which it is sought to apply the foreign law is substantive and not procedural.

In general, each of these elements should be present where the Relevant Clearing Member and LCH enter into the LCH Agreements. Accordingly, except where unusual circumstances exist, a New Zealand court would give effect to the choice of English law under Regulation 51 of the Regulations.

(b) **Submission to jurisdiction**

The parties' submission to the exclusive jurisdiction of the courts of England should be recognised in New Zealand. When so recognised, a New Zealand court will stay proceedings instituted in New Zealand on the grounds of *forum non conveniens* unless the claimant (in practice, likely to be the Relevant Clearing Member) establishes that New Zealand is clearly and distinctly the more appropriate forum.¹⁸

¹⁸ *Spiliada Maritime Corporation v Cansulex Ltd* [1987] AC 460 (HL).

2.6 ***Will the courts of New Zealand uphold the judgment of the English courts or an English arbitration award?***

(a) **Enforcement of English judgment**

The Reciprocal Enforcement of Judgments Act 1934 contains a regime for the recognition and enforcement in New Zealand of judgments of English courts. Accordingly, a judgment obtained in a superior court in England against a Relevant Clearing Member would be enforceable without the need for further action in a New Zealand court, other than registration of the judgment (if capable of registration in full) pursuant to the Reciprocal Enforcement of Judgments Act (but subject to section 10 of that Act, which deals with the power to remove reciprocal status for the enforcement of foreign judgments), provided that:

- (i) the relevant court had jurisdiction in the circumstances of the case;¹⁹
- (ii) the judgment of the court is:
 - (A) final and conclusive;
 - (B) one under which a sum of money is payable, not being a sum payable in respect of taxes or other charges of a like nature or in respect of a fine or other penalty;
 - (C) not more than six years old;
 - (D) not wholly satisfied at the time proceedings for enforcement are taken;
 - (E) not obtained by fraud; and
 - (F) capable of being enforced in England at the time the proceedings for enforcement are taken;
- (iii) the Relevant Member received notice of the proceedings in the original court in sufficient time to enable it to defend the proceedings;
- (iv) the person registering the judgment is entitled to the rights under the judgment;
- (v) the enforcement of that judgment is not contrary to public policy in New Zealand;²⁰ and
- (vi) the matter in dispute had not, prior to proceedings in the original court, already been the subject of a final judgment in a court having jurisdiction.

(b) **Enforcement of English arbitration award**

New Zealand is a member of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958 (the **New York Convention**). Subject to certain exceptions (described below), the New York Convention requires the courts of contracting states to recognise agreements to submit to arbitration, and recognise and enforce foreign arbitration awards.

¹⁹ As we say at 2.5 above, the Relevant Clearing Member's submission in the Regulations to the exclusive jurisdiction of the English courts should be recognised in New Zealand.

²⁰ We are not aware of any rule of New Zealand public policy that might apply in these circumstances.

Arbitration Act 1996

The Arbitration Act contains procedures for the enforcement of a foreign arbitration awards in New Zealand. Subject to certain exceptions (described below), a court in New Zealand, in accordance with the Arbitration Act, would recognise and enforce a duly obtained English arbitration award.

Exceptions

The Arbitration Act contains grounds for refusing recognition and enforcement of an arbitration award that are identical to those set out in the New York Convention. Among the grounds on which recognition or enforcement may be refused in a New Zealand court are that the New Zealand court finds that:

- (i) the subject matter of the dispute is not capable of settlement by arbitration under the law of New Zealand; or
- (ii) the recognition or enforcement of the arbitration award would be contrary to the public policy of New Zealand; for this purpose, an arbitration award is contrary to the public policy of New Zealand if:
 - (A) the making of the arbitration award was induced or affected by fraud or corruption; or
 - (B) a breach of the rules of natural justice occurred:
 - (1) during the arbitral proceedings; or
 - (2) in connection with the making of the arbitration award.

2.7 *Are there any “public policy” considerations that the courts of the New Zealand may take into account in determining matters related to choice of law and/or the enforcement of foreign judgments?*

Yes. In determining matters related to choice of law and/or the enforcement of foreign judgments, a New Zealand court is required to take into account public policy. However, in making such a determination, a court is not constrained by previous public policy considerations. Accordingly, it is not possible to say with certainty what public policy issues a court might take into account in a particular circumstance. That being said, we are not aware of any rule of New Zealand public policy that would prevent a New Zealand court:

- (a) recognising, and giving effect to, the choice of English law under Regulation 51 of the Regulations; or
- (b) recognising and enforcing a judgment of an English court (provided that the requirements of the Reciprocal Enforcement of Judgments Act are otherwise satisfied).

Insolvency, security, set-off and netting

2.8 *Please identify the different types of insolvency proceedings and pre-insolvency reorganisation, restructuring and/or resolution measures in respect of Relevant Clearing Members under the laws of New Zealand. 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?*

(a) **Insolvency Proceedings and Reorganisation Measure**

The insolvency proceedings to which a Relevant Clearing Member could be subjected under New Zealand law are the following:

- (i) liquidation;
- (ii) voluntary administration;
- (iii) statutory management;²¹ and
- (iv) receivership,

(together, the **Insolvency Proceedings**). The Insolvency Proceedings are summarised in Schedule 4.

In addition, a Relevant Clearing Member could enter into a compromise with its creditors under Part 14 of the Companies Act. For the purposes of this opinion, compromise is a **Reorganisation Measure**.²² The compromise regime is also summarised in Schedule 4.

(b) **Rules 3 and 5 of the Default Rules**

In our view, because an administrator may be appointed to a Relevant Clearing Member otherwise than by means of a petition or court order, Rule 5 is not adequate as currently drafted to ensure that LCH has the right to liquidate, transfer or otherwise deal with Contracts in accordance with the Default Rules if an administrator is appointed to a Relevant Clearing Member by a means other than a court order (e.g., by a board resolution). It is arguable that such an event could be taken to be an event analogous to those events specified in Rule 5(j) (in terms of Rule 5(p)), although that would be an issue of construction to be determined by English law. However, for the sake of clarity, we recommend that the following amendment be made to Rule 5(j):

- (j) in respect of the Clearing Member, a receiver, manager, administrator or administrative receiver is appointed or a composition or scheme of arrangement is approved by the court;

Otherwise, we consider that the Insolvency Proceedings and the Reorganisation Measure are adequately 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, and that there are no other events or procedures relevant to Rule 3 or Rule 5 of the Default Rules that should be included.

2.9 *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*

²¹ For completeness, we note that Relevant Clearing Members that are registered banks in New Zealand, and that have retail deposits in excess of NZ\$1 billion (each, a **large bank**), could be made subject to the Reserve Bank's Open Bank Resolution (OBR) policy in the event of their statutory management. OBR is not, of itself, an insolvency regime. Rather, OBR is a tool that may be used by the Reserve Bank to assist in managing the initial stages of the statutory management of a large bank. OBR does not confer additional powers on a statutory manager, or otherwise modify the statutory management regime. Accordingly, we do not discuss OBR further in this opinion.

²² We note that a deed of company arrangement entered into as a result of a voluntary administration can also be used to effect a reorganisation of an insolvent or financially distressed company.

the purposes of enforcing against Collateral provided to it by a Relevant Clearing Member under the Deed of Charge?

(a) Effectiveness of the Security Documents

For the reasons given in Schedule 3, in our view, each of the Deed of Charge and the Clearing Member Contract (the **Security Documents**) gives rise to a security interest for the purposes of the PPSA. Accordingly, we have considered this question in the context of the Security Documents generally, rather than limiting our response to the Deed of Charge.

The primary New Zealand legislation relevant to the analysis of the effectiveness of any security interests arising under the Security Documents, in the context of Insolvency Proceedings or a Reorganisation Measure in respect of a Relevant Clearing Member, is the PPSA. We outline in Schedule 3 certain parts of the PPSA that are relevant to this opinion. A number of the terms and concepts used below are defined and explained in Schedule 3.

Position if New Zealand law governs effectiveness

If, under the conflict of laws rules described in Schedule 3, New Zealand law governs issues of validity of a security interest, we would expect a New Zealand court to recognise the validity of a security interest created under the Security Documents assuming it is valid under its governing law. This reflects the common law conflict of laws rule that a New Zealand court recognises the validity of a contract that is both materially valid and formally valid under its governing law.²³

In addition, our view is that any security interest arising under the Security Documents would be enforceable against third parties in New Zealand on the basis that each such security interest is provided for under a written agreement that will be signed by the Relevant Clearing Member and that will contain an adequate description of the collateral to which the security interest is intended to attach.²⁴

Finally, we note that section 35 of the PPSA provides that:

Except as otherwise provided by this Act or any other Act or rule of law or equity, a security agreement is effective according to its terms.

In our view, each Security Document would be a “security agreement” for this purpose.

(b) Is there anything that would prevent LCH from enforcing its rights under the Security Documents?

Yes, in certain circumstances, depending on the nature of the Insolvency Proceedings or Reorganisation Measure to which the Relevant Clearing Member is subject.

Liquidation

Liquidation is a distributive, rather than a rehabilitative, regime. The general scheme of the liquidation provisions in the Companies Act is that secured creditors should be able to exercise their rights independently of the liquidation of the insolvent company.

²³ Dicey, Morris & Collins, *The Conflict of Laws* (15th ed., 2012), para.s 32-121 and 32-128.

²⁴ Section 36(1) of the PPSA.

Accordingly, LCH's rights under the Security Documents should not be affected by the liquidation of a Relevant Clearing Member, except as outlined in our response at 2.11.

Administration

Administration is a more rehabilitative regime than liquidation. The administration regime is intended to freeze a company's financial position while the administrator and the creditors negotiate the company's future. In particular, section 239ABC of the Companies Act provides that:

Subject to subpart 10, a person must not, during the administration of a company, enforce a charge over the property of the company, except-

- (a) with the administrator's written consent; or
- (b) with the permission of the Court.

In this context, "charge" is defined to include:

a right or interest in relation to property owned by a company, by virtue of which a creditor of the company is entitled to claim payment in priority to [non-preferential unsecured creditors] ...

Section 239ABC will, therefore, apply if a Security Document creates a "charge" under its governing law or if a court decides that the issue involves mandatory New Zealand law and that, under New Zealand law, a "charge" is created.

However, the moratorium in this provision is expressed to be subject to subpart 10. Subpart 10 (more specifically, sections 239ABL and 239ABM) allows the enforcement of a charge over the property of a company in administration where:

- (i) a secured creditor having a charge over all, or substantially all, of the company's property begins enforcing²⁵ the charge no later than the 10th working day after the commencement of the administration; or
- (ii) any secured creditor has begun enforcing its charge prior to the commencement of the administration. However, in this case, the administrator may apply to the court for an order restraining the secured creditor's actions. Any such order granted must adequately protect the secured creditor's interests.

Accordingly, where this moratorium applies, LCH would be unable to exercise its secured creditor rights unless it qualifies under one of the two exemptions. In practice, it is unlikely that LCH would have all- (or substantially all-) assets security over the Relevant Clearing Member. Assuming it does not, LCH's only protection would be if it were able to begin enforcement prior to the commencement of administration. Obtaining prompt notice of an impending administration would, of course, then be crucial.

Section 239ACT(2) provides that, where a deed of company arrangement has been entered into in relation to a company in administration, this does not prevent a secured creditor from enforcing its charge, except so far as:

- (i) the deed provides otherwise in relation to a secured creditor who voted in favour of the resolution to execute that deed; or

²⁵ "Enforce" is broadly defined in section 239ABK to include the exercise of any secured creditor right arising under contract.

- (ii) the court orders otherwise under section 239ACV(1)(a).

Statutory management

Like administration, statutory management is a more rehabilitative regime. In broad terms, making a party subject to statutory management in New Zealand creates a moratorium in relation to that party's affairs.²⁶ The statutory management moratorium provides that no person may, among other things:

...

- (d) Enter into possession, sell, or appoint a receiver of the property of that corporation, or property in respect of which the corporation has an equity of redemption: [or]
- (e) Exercise or continue any power or rights under, or in pursuance of, any mortgage, charge, debenture, instrument or other security over the property of the corporation:

Accordingly, if, under the governing law of the Security Documents, the Collateral remains "the property of" the Relevant Clearing Member, the statutory moratorium prohibits the exercise by LCH of its secured creditor rights.

Receivership

A receiver, manager, or receiver and manager of a New Zealand company's affairs may be appointed either by the terms of a contract (typically, a contract granting a security interest) or by a court. In either case, the Receiverships Act applies. A receiver is generally appointed to manage all or substantially all of the company's affairs.

The options available to a receiver include:

- (i) selling the assets of the company in respect of which the receiver is appointed; or
- (ii) continuing to run the business of the company as a going concern; or
- (iii) putting the company into liquidation.

In our view, LCH's rights under the Security Documents should not be affected by the appointment of receiver to a Relevant Clearing Member.

Compromise

A compromise is binding on the company and on all creditors to whom notice of the proposal is given. Accordingly, a compromise could affect LCH's rights under the Security Documents, but only to the extent that any debt arising under the Security Documents was the subject of a compromise proposal and LCH had notice of that proposal.

- (c) ***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 Security Documents?***

²⁶ Section 42 of the CIM Act. The equivalent provision in the Reserve Bank Act is section 122.

There are two parts of the PPSA that are relevant in this context: section 25 (which requires rights arising under a security agreement to be exercised in a certain manner) and Part 9 (which governs the enforcement of security interests). However, as the PPSA's conflict of laws rules do not apply to enforcement issues,²⁷ it is unclear in what circumstances section 25 or Part 9 will apply.

It is possible that a New Zealand court would hold that issues relating to enforcement should be determined by the governing law of the Security Documents. Alternatively (and in our view more likely), a New Zealand court may hold that, if the PPSA governs validity and perfection issues, it should also govern enforcement issues. A New Zealand court could also hold that enforcement issues are procedural, and not substantive, and that the PPSA's enforcement rules should therefore apply as part of the *lex fori*. In either of the latter two cases, section 25 and Part 9 apply. The following discussion assumes that section 25 and Part 9 apply.

Exercise of rights arising under security agreement

Section 25(1) provides that:

All rights, duties, or obligations that arise under a security agreement or this Act must be exercised or discharged in good faith and in accordance with reasonable standards of commercial practice.

There are two standards that a secured party must satisfy: good faith and the reasonable standard of commercial practice. "Good faith" is not defined in the PPSA, although section 25(2) provides that a person does not act in bad faith merely because they act with knowledge of the interest of another person. There are no guidelines in the PPSA as to what are "reasonable standards of commercial practice".

Enforcement

The relevant provisions of Part 9 are outlined below. We discuss first the three enforcement options available to a secured party (sale, application and retention), then the rights of redemption and reinstatement and, finally, the scope to contract out of Part 9.

Sale of collateral

Section 109(1)(a) allows a secured party to take possession of (if it has not already) and sell collateral when the debtor is in "default" under the security agreement. "Default" means:

- (a) The failure to pay or otherwise perform the obligation secured when due; or
- (b) The occurrence of an event that, under the security agreement, gives the secured party the right to enforce the security:

The occurrence of one of the events specified in Rule 5 of the Default Rules constitutes a "default" under the PPSA.

²⁷ As mentioned in Schedule 3, the PPSA's conflict of laws rules only apply to issues of "validity, perfection, and the effect of perfection or non-perfection".

If a secured party elects to sell collateral, it owes a duty to the debtor and to other secured parties to obtain the best price reasonably obtainable as at the time of sale.²⁸ The sale may be by auction, public tender, private sale or another method.²⁹

The secured party must give at least 10 working days' notice of the sale to the debtor and to other secured creditors.³⁰ However, the notice requirement does not apply in certain circumstances - in particular, where the collateral is foreign currency or where the secured party believes on reasonable grounds that the collateral will decline substantially in value if it is not disposed of immediately.³¹

Within 15 working days of the sale, the secured party must give a written statement of account, specifying certain details, to the debtor and to each other secured creditor.³² The secured party must pay any surplus, first, to the other secured parties according to their respective priorities, then to the debtor.³³

Application of collateral

As an alternative to selling collateral, a secured party with priority over all other secured parties may, if the debtor is in default, apply an account receivable (which, we conclude in Schedule 3, includes cash under the Security Documents) or an investment security taken as collateral to the satisfaction of the secured obligation.³⁴ This alternative is not available in respect of intangible securities.

Retention of collateral

As a further alternative to selling collateral, a secured party with priority over all other secured parties may, after a default by the debtor, propose to take the collateral in satisfaction of the secured obligation.³⁵ It appears that the principal distinction between this alternative and the application of collateral alternative referred to above is that the latter contemplates the collateral being held by a third party, whereas the former does not.³⁶ Arguably, this alternative requires the secured party to foreclose on the collateral in satisfaction of the *entire* secured obligation, rather than that part of the secured obligation representing the value of the collateral being retained.

²⁸ Section 110 of the PPSA.

²⁹ Section 113 of the PPSA.

³⁰ A form of notice is prescribed in Form 1 of Schedule 2 of the Personal Properties Securities Regulations 2001 (*PPS Regulations*). Generally, where the enforcement provisions in the PPSA require a secured party to give a notice to other secured creditors, notice need only be given to:

- (a) a person who has registered a financing statement in respect of the collateral that is effective at the time the secured party took possession; and
- (b) a person that has given the secured party notice that it claims an interest in the collateral.

³¹ Section 114(2) of the PPSA.

³² Section 116 of the PPSA.

³³ Sections 116A and 117 of the PPSA.

³⁴ Section 108 of the PPSA.

³⁵ Section 120 of the PPSA.

³⁶ One further difference is that the secured party is required to give notice of its intention to exercise its right to *retain* collateral, but is not required to give notice if it elects to *apply* collateral.

The secured party must give notice to the debtor and to all other secured parties of its proposal to retain the collateral.³⁷ The secured party must sell, rather than retain, the collateral under the procedure outlined above if a recipient of the notice objects in writing within 10 working days of receipt of the notice.³⁸ If no such objection is received within that 10-working day period, the secured party is deemed to have irrevocably elected to take the collateral in satisfaction of the secured obligation.³⁹

Right of redemption and reinstatement

At any time before the secured party takes one of the above three steps:

- (i) the debtor or any other secured party may redeem the collateral by paying the secured amount plus the secured party's reasonable expenses;⁴⁰ or
- (ii) the debtor may, unless it has otherwise agreed in writing after default, reinstate the security agreement by paying the sum in arrears (exclusive of acceleration), remedying any other default and paying the secured party's reasonable expenses in enforcing the security agreement.⁴¹ The debtor may only reinstate a security agreement twice if the term of that agreement is no more than 12 months, and twice in each year if the term is more than 12 months.⁴²

It is not clear how these reinstatement provisions would operate in the context of the Security Documents. Those provisions were drafted in contemplation of a security agreement securing obligations under a financing-type facility. They do not fit well with an agreement securing obligations under the LCH Agreements.

Contracting out

Section 107 of the PPSA allows the parties to a security agreement to contract out of certain provisions of Part 9. The parties may contract out of, among others:

- (i) section 108 (secured party's right to apply collateral);
- (ii) section 109 (secured party's right to sell collateral);
- (iii) section 114(1)(a) (secured party's obligation to give notice of sale to debtor);
- (iv) section 120(1) (secured party's right to retain collateral); and
- (v) sections 133 and 134 (debtor's right of reinstatement).

Essentially, these are provisions that do not affect the rights of third parties.

The parties may also contract out of, among others, the debtor's right to:

³⁷ A form of notice is prescribed in Form 2 of Schedule 2 of the PPS Regulations.

³⁸ Section 121 of the PPSA.

³⁹ Section 123(1) of the PPSA.

⁴⁰ Section 132(1) of the PPSA.

⁴¹ Section 133 of the PPSA.

⁴² Section 134 of the PPSA.

- (i) receive a statement of account under section 116;
- (ii) receive notice of a secured party's proposal to retain collateral under section 120(2); and
- (iii) object to a secured party's proposal to retain collateral under section 121.

We recommend that LCH take advantage of this ability to contract out to the fullest extent permitted by the PPSA.

Entitlement to damages for breach of PPSA's obligations

Section 176(1) of the PPSA provides that, if a person fails to discharge any duty or obligation imposed on that person by that Act, the person to whom the duty or obligation is owed and any other person who can reasonably be expected to rely on performance of the duty or obligation has a right to recover damages for any loss or damage that was reasonably foreseeable as likely to result from the failure.

2.10 ***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? If the answer is the affirmative, please identify those specific Insolvency Proceedings and/or Reorganisation Measures to which the answer applies and briefly explain your reasoning.***

(a) **Actions under Rule 6**

Rule 6 of the Default Rules sets out a wide range of actions that LCH may take under Rule 3 in respect of the Defaulter or otherwise. In broad terms, these actions involve security enforcement, the transfer of, or dealing with, rights, obligations or property of the Relevant Clearing Member, and other matters relating to administration of the Defaulter's open Contracts.

Whether LCH could enforce its rights under Rule 6 of the Default Rules in these circumstances depends on the nature of the Insolvency Proceedings or the Reorganisation Measure to which the Relevant Clearing Member is subject. We consider the position under each relevant regime, below.⁴³

Liquidation

Section 248(1)(c) of the Companies Act provides that, with effect from the commencement of liquidation of a company:

unless the liquidator agrees or the court orders otherwise, a person must not—

- (i) commence or continue legal proceedings against the company or in relation to its property; or

⁴³ For completeness, we note that actions taken under Rule 6 of the Default Rules would be protected by section 156Q(1)(d) of the Reserve Bank Act if the clearing system operated by LCH were to become a "designated settlement system" for the purposes of Part 5C of the Reserve Bank Act (as to which, see our response at 2.2(b) above).

- (ii) exercise or enforce, or continue to exercise or enforce, a right or remedy over or against property of the company:

However, section 248(1) is subject to section 248(2), which states that:

Subsection (1) does not affect the right of a secured creditor, subject to section 305, to take possession of, and realise or otherwise deal with, property of the company over which that creditor has a charge.

Accordingly, to the extent that the actions taken by LCH pursuant to Rule 6 of the Default Rules after the appointment of a liquidator to the Relevant Clearing Member involve:

- (i) enforcement of a security interest; or
- (ii) a transfer of, or dealing with, rights, obligations or property that is subject to a security interest created by the Security Documents,

LCH should have the right to take those actions pursuant to Rule 6 in the liquidation of the Relevant Clearing Member. LCH should also be able to close out open Contracts in the liquidation of the Relevant Clearing Member. Other dealings with property of the Relevant Clearing Member could, however, be restrained.

Administration

Section 239Z(1) of the Companies Act provides that, subject to certain limited exceptions:

A transaction or dealing by a company in administration, or by a person on behalf of the company, that affects the company's property is void unless the transaction or dealing was entered into—

- (a) by the administrator, on the company's behalf; or
- (b) with the administrator's prior written consent; or
- (c) under an order of the court.

It is not clear whether this prohibition would apply to steps taken pursuant to Rule 6 of the Default Rules in respect of a Relevant Clearing Member that is in administration. However, we believe the better view is that it would not.⁴⁴ That being the case, the administration of a Relevant Clearing Member should not prevent LCH from taking action pursuant to Rule 6 of the Default Rules. We emphasise, however, that the position is not clear.

In addition, see our comments at 2.9(b) above in relation to the enforcement of a charge.

⁴⁴ Our reasons for this view are, first, that these steps are not taken "by [the] company in administration". They are taken by LCH. Secondly, section 239Z(4)(a) suggests that the "transaction or dealing" must be something that the company can "enter into" – that is, a *new* contractual arrangement, as opposed to the mere exercise of rights under an *existing* contractual arrangement. Thirdly, the steps taken do not (arguably at least) affect the company's property, as that property (i.e., the contractual rights embodied in the relevant agreement) was, from the outset, subject to the rights embodied in Rule 6. In other words, those rights have always been a feature of, and therefore have always qualified, the company's "property". In effect, this third point is a restatement of the "flawed asset" analysis.

Statutory Management

As noted in our response at 2.9(b), making a party subject to statutory management creates a moratorium in relation to that party's affairs. The effect of that moratorium is that no person may, among other things:

- (i) exercise or continue any power or rights under, or in pursuance of, any mortgage, charge, debenture, instrument, or other security over the property of the Relevant Clearing Member; or
- (ii) take any action or other proceedings against the Relevant Clearing Member; or
- (iii) except in the case of a bilateral netting agreement to which section 42(7) of the CIM Act or section 122(7) of the Reserve Bank Act applies (such as the Clearing Membership Agreement),⁴⁵ exercise any right of set-off against that party.

In addition, the statutory manager is able, "despite the terms of any contract, [to] suspend in whole or in part ... the payment of any debt, or the discharge of any obligation".⁴⁶ This suspension may continue indefinitely and expressly does not "constitute a breach or repudiation" of the relevant agreement, with the result that the other party cannot cancel it for breach or repudiation at common law.

Consequently, our view is that LCH would be restrained from taking the actions contemplated by Rule 6 of the Default Rules against a Relevant Clearing Member that has been made subject to statutory management. However, see our comments at 2.9(b) above regarding the position where the Collateral does not remain "the property of" the Relevant Clearing Member.

Receivership

LCH could enforce its rights under Rule 6 of the Default Rules against a Relevant Clearing Member if a receiver is appointed to that Relevant Clearing Member or its assets.

Compromise

LCH could enforce its rights under Rule 6 of the Default Rules against a Relevant Clearing Member if that Relevant Clearing Member enters into a compromise with its creditors (subject to the terms of any compromise proposal of which LCH has notice).

(b) Actions under Rule 8

Rule 8 of the Default Rules sets out the process for LCH to complete in order to determine any net amounts that remain payable between the Defaulter and LCH in respect of each "kind of account" as described in Rule 11(b) of the Default Rules.⁴⁷

⁴⁵ See further in paragraph (b) below and at 2.12 and in Schedule 5.

⁴⁶ Section 127(1) of the Reserve Bank Act.

⁴⁷ For completeness, we note that the process under Rule 8 of the Default Rules would be protected by sections 156Q and 156T of the Reserve Bank Act if the clearing system operated by LCH were to become a "designated settlement system" for the purposes of Part 5C of the Reserve Bank Act (as to which, see our response at 2.2(b) above).

Liquidation, statutory management and administration

In our view, the process under Rule 8 of the Default Rules would be protected by New Zealand's netting legislation (the **Netting Acts**) in the liquidation, administration or statutory management of a Relevant Clearing Member. The effect of the Netting Acts on the Clearing Membership Agreement is summarised in Schedule 5.

Receivership and compromise

In addition, we consider that the appointment of a receiver to a Relevant Clearing Member or its assets, or the entry by the Relevant Clearing Member in to a compromise with its creditors, would not affect the ability of LCH to complete the process referred to in Rule 8 of the Default Rules.

(c) **Automatic Early Termination Event**

We recommend that LCH specify that each of the following events constitute an Automatic Early Termination Event for the purpose of Rule 3 of the Default Rules:

- (i) any step is taken to appoint an administrator to a Relevant Clearing Member; or
- (ii) any step is taken to appoint a statutory manager to a Relevant Clearing Member, or a Relevant Clearing Member is declared "at risk" within the meaning of the CIM Act.

In making this recommendation, we note that there are legal risks associated with automatic early termination provisions of this nature generally – in particular, the risk that a New Zealand court would decline to enforce such a provision on the basis that it has the effect of circumventing mandatory insolvency laws. Nonetheless, we believe that this provision would be upheld in the circumstances we are considering. We should stress, however, that there is no New Zealand judicial support for the effectiveness of a provision such as this.

2.11 *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 there any special protections or exemptions for the relevant arrangements, from avoidance of challenge, available under the law of New Zealand in respect of contracts in financial markets?*

Of the insolvency and reorganisation regimes described in this opinion, the only regime that provides for transactions to be challenged during "suspect periods" is the liquidation regime.⁴⁸ However, there is a provision in the statutory management legislation that has a similar effect, although it is not linked to a "suspect period". In addition, the Property Law Act 2007 sets out rules that enable a court to order that property acquired or received under or through certain 'prejudicial dispositions' made by a debtor be restored for the benefit of creditors. We discuss each of these below.

Other than Part 5C of the Reserve Bank Act (which is discussed in our response at 2.2(b) above), there are no special protections or exemptions for the relevant arrangements, from avoidance of challenge, available under the law of New Zealand in respect of contracts in financial markets. However, if the liquidator or statutory manager of a Relevant Clearing

⁴⁸ However, three of the provisions referred to below from the Companies Act liquidation regime (sections 292, 293 and 297) also apply to a corporation that is subject to statutory management: section 55(1) of the CIM Act and section 139(1) of the Reserve Bank Act.

Member is successful in challenging a transaction, he or she may still face the practical difficulty of enforcing the relevant court order if the Collateral is located outside New Zealand.

(a) **Liquidation**

There are two provisions in the Companies Act under which a liquidator could challenge a transaction entered into by a Relevant Clearing Member during the applicable suspect period. These are section 292 (insolvent transaction voidable) and section 297 (transactions at undervalue). A third provision could be added if the LCH Agreements create a “charge” under their governing law: section 293 (voidable charges). Where a “charge is created, section 305 prescribes the rights and duties of the secured party. Each of these provisions is considered below.

Section 292 (insolvent transactions voidable)

Section 292(1) provides that a transaction by a company is voidable by its liquidator if the transaction is an “insolvent transaction” that is entered into within the “specified period” (two years prior to the commencement of the liquidation).

“Insolvent transaction” is defined to mean:

a transaction⁴⁹ by a company that –

- (a) is entered into at a time when the company is unable to pay its due debts; and
- (b) enables another person to receive more towards satisfaction of a debt owed by the company than the person would receive, or would be likely to receive, in the company’s liquidation.

There is a reversed onus provision in section 292(4A), which states that, unless the contrary is proved, a transaction that took place within the period of six months prior to the liquidation is presumed to have been made at a time when the company was unable to pay its debts.

Section 292(4B) sets out the so-called “running account” exception, which provides that:

Where –

- (a) a transaction is, for commercial purposes, an integral part of a continuing business relationship (for example, a running account) between a company and a creditor of the company (including a relationship to which other persons are parties); and
- (b) in the course of the relationship, the level of the company’s net indebtedness to the creditor is increased and reduced from time to time as the result of a series of transactions forming part of the relationship;

then –

- (c) subsection (1) applies in relation to all the transactions forming part of the relationship as if they together constituted a single transaction; and
- (d) the transaction referred to in paragraph (a) may only be taken to be an insolvent transaction voidable by the liquidator if the effect of applying subsection (1) in

⁴⁹ A “transaction” is defined to include a conveyance or transfer of property by the company in liquidation or the creation of a charge over that property.

accordance with paragraph (c) is that the single transaction referred to in paragraph (c) is taken to be an insolvent transaction voidable by the liquidator.

The effect of this exception is to treat all transactions that make up a continuing business relationship as one single transaction. A transaction within that business relationship may only be set aside under section 292 if the deemed single transaction (i.e., the overall position) is itself an insolvent transaction.

Assuming that the requirements of the following provisions were met:

- (i) section 292(1)(b) (transaction entered into within two years of the liquidation); and
- (ii) section 292(2)(a) (transaction entered into at a time when the Relevant Clearing Member was unable to pay its due debts),

then LCH would need either:

- (iii) to negate section 292(2)(b) (LCH must receive more towards satisfaction of a debt than in the liquidation);⁵⁰ or
- (iv) to rely on the “running account” exception.

Whether either exception is available is a question of fact in each case.

Even if all the requirements of section 292(1) were satisfied, LCH could still avoid a transaction being set aside by the liquidator of a Relevant Clearing Member. Section 296(3) of the Companies Act states that:

A court must not order the recovery of property of a company (or its equivalent value) by a liquidator, whether under this Act, any other enactment, or in law or in equity, if the person from whom recovery is sought (A) proves that when A received the property –

- (a) A acted in good faith; and
- (b) a reasonable person in A's position would not have suspected, and A did not have reasonable grounds for suspecting, that the company was, or would become, insolvent; and
- (c) A gave value for the property or altered A's position in the reasonably held belief that the transfer of the property to A was valid and would not be set aside.

LCH has the onus of proof to establish that all the elements of section 296(3) are satisfied.⁵¹ In this regard:

- (i) the good faith element is likely to be established if LCH had no knowledge of the financial position of the Relevant Clearing Member at the transaction was entered into and, consequently, honestly believed that it was not gaining a preference;
- (ii) whether there were reasonable grounds to suspect the Relevant Clearing Member's insolvency is likely to be purely a question of fact; and

⁵⁰ The extent of any preference is to be measured against what creditors would receive in the *actual* liquidation, not what they would have received in a *hypothetical* liquidation occurring at the time of the transaction. In addition, it is not necessary for a liquidator to prove that the general body of creditors of the company had been disadvantaged by the impugned transaction: *Levin v Market Square Trust* [2007] 3 NZLR 391 (CA).

⁵¹ *In re Holm (a bankrupt)* [1974] 2 NZLR 455 (SC).

- (iii) in the context of the two alternatives in paragraph (c), LCH should be regarded as giving value for the transfer (see the discussion on this point below in the context of section 297).⁵²

Section 297 (transactions at undervalue)

Section 297 of the Companies Act provides that:

- (1) Under subsection (2) the liquidator may recover from a person (X) the amount C in the formula $A - B = C$, where –
- (a) A is the value that X received from a company under a transaction to which the company was or is a party; and
 - (b) B is the value (if any) that the company received from X under the transaction.
- (2) The liquidator may recover the difference in value (that is, C in the formula in subsection (1)) from X if –
- (a) the company entered into the transaction within the [period of two years prior to the commencement of the liquidation]; and
 - (b) either –
 - (i) the company was unable to pay its due debts when it entered into the transaction; or
 - (ii) the company became unable to pay its due debts as a result of entering into the transaction.

“Transaction” has the same meaning as in section 292(3) and, therefore, includes a conveyance or transfer of property by the company in liquidation or the creation of a charge over that property.

Section 297(1) is difficult to construe in the context of a transfer of Collateral pursuant to the Rulebook. This is because, in terms of paragraph (b), there is no explicit consideration received by a Relevant Clearing Member in return for that transfer. There are two possible interpretations.

The first interpretation is that consideration, in the context of the Clearing Member Contract, should be looked at on a transfer-by-transfer basis. There must be separate and identifiable consideration provided to the Relevant Clearing Member at the time of each transfer of Collateral. This interpretation makes transfers of Collateral under the Rulebook vulnerable to challenge under section 297(1) (assuming that the other requirements of section 297 are met). In particular, the fact that transfers of Collateral typically occur *after* the underlying Contracts are entered into makes it easier to argue that the Relevant Clearing Member is receiving little benefit in return. A liquidator taking this interpretation to its extreme could argue that LCH had not in fact provided *any* consideration for a transfer of Collateral. Therefore, the liquidator should be entitled to recover the full value of the Collateral.

The second interpretation is that consideration, in the context of the Clearing Member Contract, should be viewed not on a transfer-by-transfer basis but on the basis of the entire set of related transactions. These related transactions would include the initial entry into the LCH Agreements, as well as the underlying Contracts secured by the

⁵² In *Allied Concrete Limited v Meltzer* [2015] NZSC 7, the Supreme Court held that original value given by a creditor, prior to the impugned transaction, would be sufficient provided that the value was real and substantial.

Collateral transferred. Under this interpretation, consideration *is* provided by LCH for transfers of Collateral (but prior to the transfer and not simultaneously with it). The consideration is LCH's contractual promises embodied in the documentation for these related transactions.

The second interpretation is, in our view, the better approach. It is consistent with the principal aim of section 297, which is to avoid the assets of a company being depleted through its entry into transactions other than on commercial terms. That is, the assets of the Relevant Clearing Member cannot be depleted by a transfer of Collateral if the Collateral can only be applied to the extent of the Relevant Clearing Member's obligations, and excess Collateral must be returned.⁵³

Section 293 (voidable charges)

Section 293 of the Companies Act provides that:

- (1) A charge over any property or undertaking of a company is voidable by the liquidator if –
 - (a) the charge was given within the [period of two years prior to the commencement of the liquidation]; and
 - (b) immediately after the charge was given, the company was unable to pay its due debts.

- (1A) Subsection (1) does not apply if –
 - (a) the charge secures money actually advanced or paid, or the actual price or value of property sold or supplied to the company, or any other valuable consideration given in good faith by the grantee of the charge at the time of, or at any time after, the giving of the charge; or
 - (b) the charge is in substitution for a charge given before the specified period.

Section 293 will only apply if the LCH Agreements create a "charge" under their governing law. The definition of the term "charge" is set out in our response at 2.9(b) above, under the heading "Administration".

There is a reversed onus provision in section 293(2), similar to that in section 292(4A) (discussed above). Section 293(2) states that, unless the contrary is proved, a company giving a charge within the period of six months before the commencement of its liquidation is presumed to have been unable to pay its due debts immediately after giving the charge.

If section 293 were applicable, LCH would most likely seek to rely on the exception in section 293(1A)(a) to avoid the charge being set aside. In our view, LCH would have a good case to the extent that the collateral secures the Relevant Clearing Member's performance of Contracts entered into on or after the date on which the LCH Agreements were entered into. Its argument would be that the charge "secures...other valuable consideration given in good faith by the grantee of the charge at the time of, or at any time after, the giving of the charge". The "valuable consideration" in this case would be the contractual rights embodied in the Contracts.

However, the LCH Agreements could be set aside to the extent they purport to secure the Relevant Clearing Member's performance of Contracts entered into prior to the

⁵³ *Re M C Bacon Limited* [1990] BCLC 324 (Ch D).

LCH Agreements being executed.⁵⁴ In that case, LCH could still avoid the LCH Agreements being set aside by proving to the court that section 296(3) is applicable.⁵⁵

The substitution of Collateral by the Relevant Clearing Member during the suspect period should not render the LCH Agreements voidable provided that the value of the substitute Collateral is no greater than the value of the Collateral it replaces.⁵⁶

Section 305 (rights and duties of secured creditors)

If the LCH Agreements create a “charge” under their governing law, LCH will be a “secured creditor” for the purposes of the Companies Act. Section 305 permits a secured creditor to realise the property of the company in liquidation and apply the sale proceeds in reduction of the indebtedness due to it. Section 305 also allows a secured creditor to value the property subject to the security interest, as opposed to selling it, and to claim in the liquidation as an unsecured creditor for the balance due. This second procedure is subject to a number of additional requirements (for example, the valuation may be rejected by the liquidator). For that reason, the second procedure is less likely to be used by a person in LCH’s position than the first.

(b) **Statutory management**

Section 54(1) of the CIM Act⁵⁷ provides that:

In any case where, whether before or after the passing of this Act, -

- (a) Any property has been acquired by a person in circumstances which cause it to be *just and equitable* that that person should hold it upon trust for any corporation that has been declared to be subject to statutory management; or
- (b) Any property has been *improperly disposed of*, whether or not the property has become subject to a trust, -

the Court may, if it thinks fit, make an order –

- (c) That the property be transferred or delivered to the statutory manager;
- (d) That any person who acquired or received the property, or his or her administrator, shall pay to the statutory manager a sum not exceeding the value of that property.

(our emphasis)

There is no definition of “property” in the CIM Act. However, it has been held that “property” in this context includes both money and bank deposits.⁵⁸ On that basis, “property” could apply to both cash and other forms of intangible property.

It is a question of fact in each case whether the “just and equitable” test in paragraph (a), or the “improperly disposed of” test in paragraph (b), has been satisfied. A lack of judicial authority on point makes it difficult to identify any guidelines as to when section

⁵⁴ See *Re C & D Webster Ltd (in liquidation)* [1995] 3 NZLR 590 (HC). That said, the New Zealand courts have typically adopted a liberal interpretation of the phrase “at the time of”. Charges granted a number of weeks after consideration was given by the grantee have been held to be granted “at the time of” the giving of that consideration. What is important is that, at the outset (i.e., when a Contract is entered into), there is a promise to grant security.

⁵⁵ Section 296(3) is discussed above in the context of section 292 (insolvent transaction voidable).

⁵⁶ Section 293(1A)(b) and (3).

⁵⁷ The equivalent provision in the Reserve Bank Act is section 138(1).

⁵⁸ *Equiticorp Industries Group Limited (in statutory management) v The Crown* (judgment no. 47) [1998] 2 NZLR 481, 706-7 (HC).

54(1) may be applicable. Those cases that *have* considered section 54 tend to involve clear cut situations where it would be difficult to argue against the court making an order. However, if section 54(1) *did* apply in the circumstances we are considering, it is likely that the exception set out in section 54(3) would be available to LCH. That provision states that:

No order made pursuant to this section shall deprive any other person of any estate or interest in the property if the estate or interest was acquired in good faith and for valuable consideration.⁵⁹

(c) **Property Law Act**

Section 346 of the Property Law Act states that subpart 6 of Part 6 of that Act applies to dispositions⁶⁰ of property made:

- (i) by a debtor who:
 - (A) was insolvent at the time, or became insolvent as a result, of making the disposition; or
 - (B) was engaged, or was about to engage, in a business or transaction for which its remaining assets were, given the nature of the business or transaction, unreasonably small; or
 - (C) intended to incur, or believed, or reasonably should have believed, that it would incur, debts beyond its ability to pay; and
- (ii) with intent to prejudice a creditor, or by way of gift, or without receiving reasonably equivalent value in exchange.

A liquidator or a creditor that has been prejudiced by such a disposition can apply to the court for an order that either vests the relevant property in, or requires the recipient of the property to pay reasonable compensation to, the debtor (or other specified person).

Section 349 protects certain recipients of property that could otherwise be the subject of such a court order. In particular, section 349(1) provides that an order may not be made in relation to a person who acquired the property for valuable consideration and in good faith without knowledge of the fact that the property had been the subject of a disposition to which subpart 6 applies, or an acquirer from such person.

2.12 *Is there relevant netting legislation in New Zealand 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?*

Sections 310 and 239AEG of the Companies Act will be relevant to any rights of set-off, consolidation or combination in Rule 8 of the Default Rules if the Netting Acts were not to

⁵⁹ The exception is stated to apply if "any *other* person" (our emphasis) is deprived of an interest in the property. This suggests that the exception cannot protect the person to which section 54(1) refers (i.e., the person that acquires an interest in property directly from the corporation (in this case, LCH)). However, we expect that, in practice, both *direct* and *indirect* acquirers of an interest in the property of a corporation subject to statutory management would have the benefit of the exception in section 54(3). That is, if a *direct* acquirer acquires its interest "in good faith and for valuable consideration", it should not fall within the scope of section 54(1)(a) or (b). This seems to be the approach taken in the *Equiticorp* case.

⁶⁰ The term "disposition" is defined broadly to include a transfer, assignment, delivery or payment, and the grant or creation of a mortgage or charge.

apply (for whatever reason) in the liquidation or administration of a Relevant Clearing Member. Those sections provide that, where there have been mutual credits, mutual debts or other mutual dealings between a company that is in liquidation or administration and a creditor of that company:

- (a) an account must be taken of what is due from one party to the other in respect of those mutual dealings;
- (b) the sum due from one party is to be set-off against any sum due from the other party; and
- (c) only the balance of the account may be claimed in the liquidation or admitted under the deed of company arrangement (as case may be) or is payable to the relevant company.

However, as we note at 2.10(b) above, our view is that the process under Rule 8 of the Default Rules would be protected by the Netting Acts in the liquidation or administration of a Relevant Clearing Member. Accordingly, we do not consider that sections 310 or 239AEG of the Companies Act would apply in these circumstances.

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

(a) Liquidation

The currency in which a claim is valued in a liquidation in New Zealand is New Zealand dollars. Section 306(2) of the Companies Act provides that:

The amount of a claim based on a debt or liability denominated in a currency other than New Zealand currency must be converted into New Zealand currency at the rate of exchange on the date of commencement of the liquidation, or, if there is more than one rate of exchange on that date, at the average of those rates.

This is so even though the amount of the claim may have to be ascertained later. While this rule applies to a claim *against* a Relevant Clearing Member in liquidation, it is not settled how a claim *by* a Relevant Clearing Member against LCH should be valued. In principle, that claim should also be converted at the rate of exchange prevailing on the commencement of liquidation.

Accordingly, while the Netting Acts give considerable freedom to parties to determine the method of calculation of the “netted balance” in their “bilateral netting agreement”, in the liquidation of an entity, the claim represented by that netted balance, once determined, becomes subject to the same rules that apply to all other claims. This includes the requirements of section 306(2).

(b) Administration

In the administration of a company, creditors advise the administrator of their claim for the purpose of having that claim included in the deed of company arrangement to be adopted by the company and its creditors. The Companies (Voluntary Administration) Regulations 2007 set out the provisions that are deemed to be included in a deed of company arrangement if they are not expressly excluded. Paragraph 8(1) of Schedule 1 of those Regulations incorporates section 306 of the Companies Act (discussed immediately above). Accordingly, the analysis set out above in relation to liquidation applies equally to administration.

(c) **Statutory management**

A payment of the net termination amount by a Relevant Clearing Member made subject to statutory management may be made in a termination currency other than New Zealand dollars. However, this is on the unlikely assumption that the statutory manager chooses to make the payment in the first place. As we state in Schedule 4, the statutory manager may suspend the payment of the net termination amount. Alternatively, the statutory manager may choose not to pay the net termination amount and rely on the statutory moratorium preventing the counterparty from bringing proceedings to recover that amount.

(d) **Receivership**

The regime for proving in a receivership will depend on the terms of the contract providing for, or governing, the appointment of the receiver.

3. Client Clearing

This section 3 considers whether the default arrangements providing for:

- (a) the porting of the Contracts entered into on behalf of a Clearing Client (**Client Contracts**) and the associated Account Balance to a Backup Clearing Member; or
- (b) the liquidation of Client Contracts and the return of the relevant Client Clearing Entitlement directly to the relevant Clearing Client or (failing that) to the relevant Defaulter for the account of such client,

would be effective in the event of a Default of a Relevant Clearing Member.

Exempting Client Clearing Rule

- 3.1 ***Please opine on the availability and effectiveness of any law, regulation or statutory provision (having the force of law) in New Zealand which (if so designated by LCH) would be expected to qualify as an Exempting Client Clearing Rule. Please clarify whether the Exempting Client Clearing Rule would be expected to apply to Relevant Clearing Members of all entity types or to only certain entity types.***

The Rulebook defines “Exempting Client Clearing Rule” to mean:

in relation to a Clearing Member, any law, regulation or statutory provision (having the force of law) of a Governmental Authority the effect of which, in the determination of the Clearing House in its absolute discretion, is to protect the operation of the Client Clearing Annex of the Default Rules from challenge under the insolvency laws applicable to that Clearing Member

In our view, section 156Q of the Reserve Bank Act would be effective to protect the operation of the Client Clearing Annex of the Default Rules from challenge if a Relevant Clearing Member becomes subject to Insolvency Proceedings or a Reorganisation Measure if (and only if) the LCH clearing system were a “designated settlement system” in New Zealand.⁶¹ We reach this conclusion notwithstanding that section 156V of the Reserve Bank Act states that nothing in section 156Q prevents:

- (a) the operation of any enactment or rule of law in relation to an “underlying transaction” (including, without limitation, sections 292, 297 and 293 of the Companies Act (as to which, see our response at 2.11(a) above)); or
- (b) any party from taking action against another party that has acted fraudulently or dishonestly, so long as the remedy sought or obtained in respect of that action does not affect the application of section 156Q.

This is because the term “underlying transaction” is defined in section 156V as follows:

- (4) In this section, *underlying transaction*—
 - (a) means a transaction that gave rise to—
 - (i) a settlement; or
 - (ii) a settlement obligation; but
 - (b) does not include—

⁶¹ Please see our response at 2.2(b) above, under the heading “Consequences of designation”, for a description of the effect of section 156Q.

- (i) a settlement instruction; or
- (ii) a settlement that was effected in accordance with the rules of a designated settlement system; or
- (iii) any novation of the obligations of a participant in a designated settlement system that was completed in accordance with the rules of that designated settlement system.

In our view, while the operation of the Client Clearing Annex clearly *affects* “underlying transactions” (e.g., through the porting of open Relevant Contracts), it does not seek to make those underlying transactions inviolable.

However, because the LCH system is not currently a designated settlement system in New Zealand, we do not discuss section 156Q of the Reserve Bank Act further in this opinion.

Default outside Insolvency Proceedings or Reorganisation Measures

- 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 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?**

Whether, prior to the commencement of any Insolvency Proceeding or Reorganisation Measure in respect of a Relevant Clearing Member, the porting of the Client Contracts and Account Balance of a Relevant Clearing Member can be challenged is a question that relates to the enforceability of contractual rights and obligations governed by English law, and must therefore be determined in accordance with English law (as the governing law of the Clearing Membership Agreement).

- 3.3 ***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?***

Whether, prior to the commencement of any Insolvency Proceeding or Reorganisation Measure in respect of a Relevant Clearing Member, actions taken by LCH to return the Client Clearing Entitlement to the relevant Clearing Client, or to the Defaulter for the account of such client, can be challenged is a question that relates principally to the enforceability of contractual rights and obligations governed by English law, and must therefore be determined in accordance with English law (as the governing law of the Clearing Membership Agreement).

Insolvency-related Default

- 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 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?***

The porting of Client Contracts may be effected by either:

- (i) a close-out of the relevant Client Contracts between LCH and the Defaulter followed by the replication of such Contracts (by the opening of new Client Contracts on the same terms) between LCH and the Backup Clearing Member (**Close-out and Replication Porting**); or
- (ii) a transfer of the relevant Client Contracts (in the form of open positions and without close-out) from the Defaulter to the Backup Clearing Member (**Transfer Porting**).

Porting Client Contracts and Account Balance through Transfer Porting

The porting of the Client Contracts and Account Balance of a Clearing Client through Transfer Porting involves the exercise of LCH's contractual rights to dispose of the property of the Relevant Clearing Member. To the extent that such property is subject to a security interest arising under the Security Documents (for example, the cash Collateral component of the Account Balance), our comments at 2.9 above regarding the effectiveness of the Security Documents following the commencement of Insolvency Proceedings against a Relevant Clearing Member would apply equally here.

For the purposes of the following response, we assume that the property represented by the Relevant Clearing Member's rights under and to the Client Contracts and Account Balance are *not* subject to any security interest in favour of LCH.

(a) **Liquidation**

Section 248(1) of the Companies Act (which is discussed in our response at 2.10(a) above, under the heading "Liquidation") would prevent any exercise, or attempted exercise, of LCH's right to effect Transfer Porting following the appointment of a liquidator to a Relevant Clearing Member. As such, a liquidator appointed to a Relevant Clearing Member could successfully challenge any action taken by LCH to effect Transfer Porting following the commencement of liquidation in respect of that Relevant Clearing Member.

(b) **Voluntary administration**

While the position is not free from doubt, section 239Z(1) of the Companies Act (which is discussed in our response at 2.10(a) above, under the heading "Administration") should not prevent any exercise, or attempted exercise, of LCH's right under the effect Transfer Porting following the appointment of an administrator to a Relevant Clearing Member.

(c) **Statutory management**

The moratorium imposed as a consequence of a party becoming subject to statutory management (which is discussed in our response at 2.10(a) above, under the heading "Statutory management") would prevent any exercise, or attempted exercise, of LCH's right effect Transfer Porting following the appointment of a statutory manager to a Relevant Clearing Member. As such, a statutory manager appointed to a Relevant Clearing Member could successfully challenge any action taken by LCH to effect Transfer Porting at a time when that Relevant Clearing Member is subject to statutory management.

(d) **Receivership**

The appointment of a receiver to a Relevant Clearing Member or its assets should not affect LCH's ability to effect Transfer Porting.

Porting Client Contracts and Account Balance through Close-out and Replication Porting

Any porting of the Client Contracts and Account Balance of a Clearing Client conducted through Close-out and Replication Porting may be subject to challenge on similar grounds.

However, our view is that, in most cases, the same result as Transfer Porting and/or Close-out and Replication Porting can be achieved through the following three-step process:

- (a) close-out of the Client Contract or the related Contract between the Defaulter and LCH;
- (b) where a net sum is payable by LCH to the Defaulter in respect of the related Contract, enforcement by the Clearing Client of the security interest under the Security Deed; and
- (c) the putting in place of contractual arrangements between LCH, the Backup Clearing Member and the Clearing Client (which may be by way of a tripartite agreement or two bilateral agreements (one between the Clearing Client and the Backup Clearing Member and the other between the Backup Clearing Member and LCH)), creating transactions (between the Clearing Client and the Backup Clearing Member and between the Backup Clearing Member and LCH) identical to the Client Contract and the related Contract between the Defaulter and LCH.

Our reasoning for this is as follows:

- (i) Client Contracts may be (A) in-the-money for the Defaulter (**ITM Positions**) or (B) out-of-the-money for the Defaulter (**OTM Positions**), at the time of the commencement of Insolvency Proceedings against the Defaulter;
- (ii) in the case of both ITM Positions and OTM Positions, where the Defaulter has posted sufficient margin to LCH (which may be by way of title transfer or under the Deed of Charge) such that, on close-out of the relevant Contracts between LCH and the Defaulter (the **Relevant Contracts**), LCH determines that a net sum is payable to the Defaulter, a net sum of the same amount should be owed by the Defaulter to the Clearing Client in respect of the Client Contracts to which such Relevant Contracts are referable;
- (iii) the security interest under the Security Deed may be enforced, whether by that Clearing Client itself or by LCH on its behalf as security trustee, so as to require LCH to pay directly to the Clearing Client the net sum owed by LCH to the Defaulter in respect of the Relevant Contracts in satisfaction of the obligation of the Defaulter to the Clearing Client in respect of the relevant Client Contracts; and
- (iv) there are no issues under New Zealand law with LCH, the Backup Clearing Member and the relevant Clearing Client agreeing between them to replicate the Relevant Contracts, Client Contracts and Account Balances referred to above (such 'replication' being of the Relevant Contracts and the Client Contracts immediately before their closing out).

However, if, for any reason, LCH determines that a net sum is payable by the Defaulter to LCH in respect of Relevant Contracts (and a net sum of the same amount is payable by the Clearing Client to the Defaulter in respect of the Client Contracts (i.e., ITM Positions to which such Relevant Contracts are referable), it will not be possible to conduct porting in the manner described above as the Security Deed creates security only over any net sum owed by LCH to the Defaulter.

The above analysis applies in respect of an ISA client. With respect to OSA clients, our view is that porting will be effective to the extent that the above analysis is applicable (i.e., that the net sum owed by LCH to the Defaulter is equal to the net sum owed by the Defaulter to the relevant Clearing Client such that enforcement of the security under the Security Deed results the Clearing Client receiving an amount from LCH equal to the amount which such Clearing Client is required to pay to the Defaulter in respect of the relevant Client Contracts).

- 3.5 ***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, on close-out of the relevant Client Contracts, LCH determines that a net sum is payable by the Defaulter to the relevant Clearing Client in respect of such Client Contracts, it will be possible for the Clearing Client (itself, or by LCH as security trustee) to enforce the security under the Security Deed and require LCH to pay or transfer the Relevant Client Clearing Return and the Relevant Account Property (both as defined under the Security Deed) directly to the relevant Clearing Client. We understand that the Client Clearing Entitlement forms part of the Relevant Client Clearing Return.

However, the relevant Clearing Client is not entitled to any payment or transfer from LCH (in respect of the Relevant Client Clearing Return and the Relevant Account Property) under the Security Deed that is in excess of the Liabilities (as defined in the Security Deed) owed by the Defaulter to the relevant Clearing Client. To the extent that the value of the Relevant Client Clearing Return and the Relevant Account Property exceeds the Liabilities owed by the Defaulter to the relevant Clearing Client, such Clearing Client will be required to return such excess value to the Defaulter.

Unless the Clearing Client (itself, or by LCH as security trustee) enforces the security under the Security Deed, LCH will be required to pay the Relevant Client Clearing Return and the Relevant Account Property to the Defaulter.

As there is no Exempt Client Clearing Rule in New Zealand for LCH, each Relevant Clearing Member will be required to enter into a Security Deed. As each Relevant Clearing Member is required to notify LCH of the beneficiaries under such Security Deed, LCH will at all times be aware of the identity of the Clearing Clients of such Relevant Clearing Member.

Reorganisation Measures

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

In our view, the implementation of a Reorganisation Measure with respect to a Relevant Clearing Member should not affect LCH's ability to exercise its rights under the Default Rules to port the Client Contracts and Account Balance of a Clearing Client to a Backup Clearing Member, subject to the terms of any compromise proposal of which LCH has notice.

- 3.7 ***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?***

In our view, the commencement of a Reorganisation Measure in respect of a Relevant Clearing Member should not affect LCH's ability to exercise its rights under the Default Rules to return the Client Clearing Entitlement to the relevant Clearing Client or to the Defaulter for the account of such client, subject to the terms of any compromise proposal of which LCH has notice.

Security Deed

- 3.8 ***Would the Security Deed provide an effective security interest under the laws of the [New Zealand] over the Account Balance or Client Clearing Entitlement in favour of the relevant Clearing Client?***

The same principles apply here as with the Security Documents. See our detailed response at 2.9(a) above in this regard.

- 3.9 ***Are there any perfection steps which would need to be taken under the laws of [New Zealand] in order for the Security Deed to be effective?***

The same principles apply here as with the Security Documents. See our detailed response at 2.4(b) above in this regard.

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

The same principles apply here as with the Security Documents. See our detailed response at 2.9(b) above in this regard.

General

- 3.11 ***Please provide brief details of any other significant legal or regulatory issues which might be expected to arise in connection with the provision by a Relevant Clearing Member of Client Clearing Services and which are not covered by the questions above.***

There are no other material issues that we wish to draw to your attention.

4. Settlement Finality

4.1 *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.*

We consider this question below in the context of LCH both being, and not being, the operator of a designated settlement system under Part 5C of the Reserve Bank Act.

LCH not designated

If Insolvency Proceedings were commenced in respect of a Relevant Clearing Member, this could affect finality of settlement of transfers of funds or securities (or both) from that Relevant Clearing Member to LCH. In particular, in the insolvency of a Relevant Clearing Member, the clawback rules outlined in the response at 2.11 above could apply. Those rules, and the period during which they could apply to transfers of funds or securities (or both), are discussed in detail in that response.

In addition to the clawback rules mentioned above, the finality of transfer settlements could be affected by one of the statutory stays outlined in the response at 2.9 and 2.10 above and in Schedule 4. For example, if an insolvent Relevant Clearing Member transferred funds or securities to LCH in contravention of one of those statutory stays, the relevant insolvency administrator may be able to bring an action against LCH for the recovery of that collateral.

LCH is designated

Overview of Part 5C settlement finality rules

The finality of settlements is an issue that is addressed in Part 5C of the Reserve Bank Act. Part 5C provides protection against clawback for certain transactions that take place within a designated settlement system. Specifically, section 156R of the Reserve Bank Act provides that:

- (1) A settlement that is effected in accordance with the rules of a designated settlement system must not, whether in whole or in part, be reversed, repaid, recovered, or set aside despite any enactment or rule of law to the contrary.
- (2) Subsection (1) extends to any application made to a New Zealand court by a foreign court, foreign representative, or foreign creditor to reverse, repay, recover, or set aside a settlement (whether in whole or in part) that relates to an insolvency (in any form, whether personal or corporate) that is within the jurisdiction of the foreign court, foreign representative, or foreign creditor.
- (3) In this section, –

foreign court means a judicial or other authority competent to control or supervise a foreign proceeding

foreign proceeding means a collective judicial or administrative proceeding in a foreign jurisdiction, including an interim proceeding, under a law relating to insolvency (in any form, whether personal or corporate), in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganisation or liquidation

foreign representative means a person or body, including one appointed on an interim basis, authorised in a foreign proceeding to administer the reorganisation or the liquidation of the debtor's assets or affairs or to act as a representative of the foreign

proceeding.

However, section 156S of the Reserve Bank Act provides for the protection in section 156R to end in certain (insolvency-related) circumstances. Section 156S states that:

- (1) Section 156R(1) does not apply to a settlement that is effected in accordance with the rules of a designated settlement system if –
 - (a) a participant in the designated settlement system in respect of whom the settlement is effected becomes subject to an insolvency event (the **insolvent participant**); and
 - (b) the settlement is effected after the insolvent participant becomes subject to an insolvency event.
- (2) Despite subsection (1), section 156R(1) applies to the settlement if –
 - (a) the settlement is effected within 24 hours after the insolvent participant becomes subject to an insolvency event; or
 - (b) the settlement instruction that gives rise to the settlement is duly authorised on behalf of the insolvent participant after the insolvent participant becomes subject to an insolvency event.

For this purpose, a participant “becomes subject to an insolvency event” on the date on which, and (if specified) the time at which, a liquidator is appointed under Part 16 of the Companies Act, an administrator is appointed under Part 15A of the Companies Act, or a statutory manager is appointed under Part 3 of the Corporations (Investigation and Management) Act 1989 (the **CIM Act**) or Part 5 of the Reserve Bank Act. However, importantly, a participant also “becomes subject to an insolvency event” where:

a person is appointed in respect of, or another event occurs that indicates the start of, a process in New Zealand or in any other country in which the company or other body corporate was incorporated, created, or established that is similar to those set out in subparagraphs (i) to (v) [i.e., liquidation, voluntary administration or statutory management];

(our emphasis)

Therefore, if a settlement is effected *after* the time at which a participant of a designated settlement system is put into liquidation or voluntary administration or becomes subject to statutory management, the settlement finality provided by section 156R of the Reserve Bank Act will only be available if:

- (a) the settlement takes place within 24 hours after the insolvent participant becomes subject to an insolvency event; or
- (b) the settlement instruction that gives rise to the settlement is duly authorised on behalf of the insolvent participant after the insolvent participant becomes subject to an insolvency event.⁶²

Moreover, given the expanded definition of “becomes subject to an insolvency event” set out above, the insolvency of a participant in a foreign (i.e., non-New Zealand) jurisdiction in which the participant is incorporated, created or established would trigger the operation of this qualification to settlement finality.

⁶² Section 156S(3) defines what “authorised on behalf of the insolvent participant” means for this purpose.

Application of Part 5C settlement finality rules to LCH

A transfer of funds or securities (or both) effected through the LCH system would, in our view, be a "settlement"⁶³ for the purposes of the Reserve Bank Act. Accordingly, if the LCH system were to become a designated settlement system in New Zealand, a transfer of funds or securities (or both) effected through that system would, in terms of section 156R, be a "settlement that is effected in accordance with the rules of a designated settlement system". As such, that transfer could not be reversed, repaid, recovered, or set aside despite any enactment or rule of law to the contrary (subject to the limitation in section 156S, mentioned above). In particular, the clawback and stay rules referred to above under the heading "LCH not designated" would not apply.

4.2 ***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.***

Once again, we consider this question below in the context of LCH both being, and not being, the operator of a designated settlement system under Part 5C of the Reserve Bank Act.

LCH not designated

We are not aware of any circumstances that might give rise to a loss of finality protection before the commencement of Insolvency Proceedings. In particular, the commencement of Reorganisation Measures would not have that effect.

LCH is designated

If the LCH system were to become a designated settlement system in New Zealand, section 156R of the Reserve Bank Act (as outlined above) would operate to preserve finality in these circumstances. The commencement of Reorganisation Measures would not (unlike the

⁶³ Under the Reserve Bank Act, "settlement" is defined to mean:

- (a) the making of a payment or the transfer of the title to, or an interest in, property—
 - (i) that is done in accordance with, or to give effect to, a settlement instruction; and
 - (ii) that is on a gross basis or that uses netting; and
 - (iii) whether by way of book entry on the accounts of a central bank or an operator of a settlement system or otherwise; or
- (b) any other act that discharges an obligation to make a payment or transfer the title to, or an interest in, property in accordance with the rules of a settlement system

In turn, a "settlement instruction" is:

an instruction by a participant in, or to an operator of, a settlement system –

- (a) that is made in accordance with the rules of that settlement system; and
- (b) that results, or is intended to result, in 1 or more settlements being effected

And a "settlement system":

- (a) means a system or arrangement for effecting settlements or processing settlement instructions in accordance with rules
- (b) includes a payment system

commencement of Insolvency Proceedings) trigger the loss, or impending loss, of this protection.

5. **Reliance**

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

We consent to a copy of this opinion being made publicly available on the addressee's website and being shown to:

- (a) actual or prospective clearing members and clearing clients;
- (b) relevant regulators; and/or
- (c) legal counsel appointed by the addressee or any person listed in (a) 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 cursive script that reads "Bell Gully". The signature is written in black ink and is positioned below the typed name "Bell Gully".

Schedule 1

Assumptions

Without limiting any of the assumptions expressed elsewhere in this opinion, for the purposes of this opinion, we assume that:

- (a) the provisions of each Document and each Contract entered into between LCH and each Relevant Clearing Member (the **Relevant Contracts**) constitute legal, valid and (other than as expressly opined on in this opinion) enforceable obligations of each party to the Documents and the Relevant Contracts (each a **Party** and, together, the **Parties**) under all relevant laws;
- (b) each Party is duly incorporated and has the capacity, power and authority under all applicable laws to enter into, and perform its obligations under, the Documents and each Relevant Contract;
- (c) each Party has taken all necessary steps to enter into, execute and deliver, be bound by and perform the Documents and each Relevant Contract, and that such steps have not been revoked or superseded;
- (d) 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 Documents and each Relevant Contract and to ensure the legality, validity, enforceability and admissibility in evidence of the Documents and each Relevant Contract in New Zealand;
- (e) the Documents are entered into by the Relevant Clearing Member, and Collateral is transferred to LCH:
 - (i) before a liquidator, administrator, receiver or statutory manager is appointed to a Relevant Clearing Member; and
 - (ii) at a time when the Relevant Clearing Member is solvent and able to pay its debts as they become due;
- (f) there are no agreements, instruments or arrangements between the Parties that modify or supersede the terms of any Document and/or any Relevant Contract;
- (g) each Relevant Contract is entered into for value on commercially reasonable terms and on an arm's length basis;
- (h) all acts, conditions or things required to be fulfilled, performed or effected in connection with the Documents or any Relevant Contract in any jurisdiction other than New Zealand have been duly fulfilled, performed and effected;
- (i) where any obligation under the Documents or any Relevant Contract is to be performed in any jurisdiction other than New Zealand, its performance will not be illegal or unenforceable under the laws of that jurisdiction;
- (j) until such time as the security interests created by the Security Documents and the Security Deed have been released, the secured property will be held by the relevant secured party in accordance with the terms of the Security Documents or the Security Deed (as applicable);

- (k) all transfers of, or dealings with, any right, obligation or property in accordance with the Documents are effected in accordance with all applicable laws (including the laws of New Zealand);
- (l) no Party is, or would be, seeking to conduct any relevant transaction or any associated activity under the Documents in a manner or for a purpose that is not evident on the face of the Document;
- (m) the Documents and each Relevant Contract have not been amended, released or discharged, and no provision in them has been waived;
- (n) each Party enters into each Relevant Contract in the same capacity and in the same right (i.e., there is mutuality⁶⁴ between the parties for the purposes of insolvency set-off under New Zealand law); and
- (o) other than as expressly contemplated by this opinion, no Party has assigned, declared any trust over or given any security interest over any of its rights to receive payment of any amount that would be taken into account in determining the net termination amount owing under the Clearing Membership Agreement.⁶⁵

⁶⁴ Mutuality is a prerequisite for the Netting Acts to apply, as a result of section 310D of the Companies Act. Under New Zealand's conflict of laws rules, the governing law of a contract should determine whether mutuality exists.

⁶⁵ The effect of this assumption is that, to the extent that the Relevant Clearing Member grants a security interest to LCH or a Clearing Client over such payment right, mutuality would be destroyed for close-out netting purposes. Accordingly, LCH or the Clearing Client (as applicable) would need to rely on its security rights rather than its netting rights in these circumstances.

Schedule 2

Qualifications

Our opinion is subject to the following qualifications:

- (a) enforcement of an obligation or a document may be subject to the following:
 - (i) a New Zealand court might decline to exercise jurisdiction over a defendant if it considers that it is not the most appropriate court for the trial of the action, or if the parties have agreed to submit disputes to the courts of, or arbitration in, another place;
 - (ii) a New Zealand court may not enforce performance of an obligation in a place if the performance of that obligation would be illegal by the laws of that place;
 - (iii) equitable remedies, such as injunctions and specific performance, are discretionary, and will normally not be ordered where damages would be an adequate remedy;
 - (iv) a New Zealand court may not give effect to an indemnity for legal costs or expenses of unsuccessful litigation brought before it or where it has itself made an order for costs;
 - (v) enforcement may be limited by statutes of limitation or by general law doctrines or statutory relief in relation to matters such as fraud, misrepresentation, duress, unconscionable conduct, frustration, estoppel, waiver or penalties;
 - (vi) enforcement may be affected by laws concerning lapse of time, moratorium, equities, liens, set-offs, counterclaims, abatements, bankruptcy, liquidation, insolvency, administration, receivership or reorganisation or by other laws that affect creditor's rights generally; however, this qualification does not limit any of the opinions that we express herein; and
 - (vii) a New Zealand court may stay proceedings if there are corresponding proceedings on foot in another jurisdiction;
- (b) if a person is vested with a discretion or may determine a matter in its opinion, the laws of New Zealand may require that the discretion be exercised reasonably or that the opinion be based on reasonable grounds;
- (c) a provision that states that a calculation, determination, certificate or opinion will be conclusive and binding may not apply if the calculation, determination, certificate or opinion is fraudulent or manifestly inaccurate, and may not prevent judicial enquiry into the merits of any claim relating to the calculation, determination, certificate or opinion;
- (d) a provision that requires that an amendment, election or waiver be in writing may not preclude an effective amendment, election or waiver made orally or by conduct;
- (e) a provision that allows an illegal, invalid or unenforceable provision to be severed from a document may not be effective and a New Zealand court may reserve to itself the decision whether that provision is severable;
- (f) an agreement to negotiate, or an agreement to agree, may not be binding;
- (g) an obligation to pay an amount (for example, default interest) may not be enforceable if the amount is held by a New Zealand court to constitute a penalty and not a genuine and reasonable pre-estimate of the loss likely to be suffered in the relevant circumstances; and

- (h) we express no opinion on:
 - (i) any provision that requires a person to do or not do something that is not clearly identified in the provision, or on any undertaking in the Document to comply with another document or agreement, unless the other document or agreement is itself a Document; or
 - (ii) the accuracy or relevance of any representation, warranty or other statement made by any Party; or
 - (iii) the title of any person to any property; or
 - (iv) the priority of any security interest.

Schedule 3

Personal Property Securities Act

1. Introduction

1.1 In this Schedule 3:

- (a) paragraph 3 provides an introduction to the PPSA and describes the application of the PPSA to the LCH Agreements;
- (b) paragraph 4 describes other concepts that are relevant to a number of the issues discussed in this opinion, including the concepts of possession, value, attachment and perfection;
- (c) paragraph 5 describes certain issues relating to conflict of laws applicable to the LCH Agreements; and
- (d) paragraph 6 describes how a secured party may obtain priority under the PPSA.

2. Executive summary

2.1 In our view, each of the Deed of Charge and the Clearing Membership Agreement gives rise to a "security interest" for the purposes of the PPSA.

2.2 Under New Zealand's conflict of laws rules, the jurisdiction whose laws would govern the validity and perfection of a security interest in collateral is:

- (a) in the case of directly held bearer securities, directly held registered securities, directly held dematerialised securities, and intermediated securities (whether classified as "investment securities" or "intangible securities" for the purposes of the PPSA), the *lex situs* (determined in the manner outlined in paragraph 5.1(a) below);
- (b) in the case of cash, the law of the location of the branch at which the relevant account is kept; and
- (c) in the case of general intangibles that constitute debts, the law of the jurisdiction where the debtor resides.

2.3 Where New Zealand law falls to determine the issue of the validity and perfection of a security interest in Collateral, we recommend that LCH register a financing statement to perfect its security interest in intangible securities and general intangibles.⁶⁶

3. Application of the PPSA to the LCH Agreements

3.1 The PPSA applies to "security interests". A "security interest" is a type of proprietary interest in "personal property". Accordingly, the definitions of "personal property" and "security interest" are the key to determining whether an LCH Agreement is subject to the PPSA.

3.2 The PPSA defines "personal property" to include "chattel paper, documents of title, goods, intangibles, investment securities, money, and negotiable instruments". For the purposes of this opinion, the two categories of most relevance are "investment securities" and

⁶⁶ However, see footnote 7 in relation to the super-priority conferred on the operator of a designated settlement system.

“intangibles”. To these we add a third category – “proceeds” – which is a derivative of the first two categories. We discuss each in turn.

(a) “Investment securities”

An “investment security”:

- (a) means –
 - (i) a writing (whether or not in the form of a security certificate) that is recognised in the place in which it is issued or dealt with as evidencing a... share, right to participate, or other interest in property or an enterprise, or that evidences an obligation of the issuer, and that, in the ordinary course of business, is transferred or withdrawn by –
 - (ii) delivery with any necessary endorsement, assignment, or registration in the records of the issuer or agent of the issuer ...; or
 - (iii) an entry in the records of a clearing house or securities depository; or
 - (iv) an entry in the records maintained for that purpose by or on behalf of the issuer; or
 - (v) an entry in the records maintained for that purpose by or on behalf of the nominee;
 - (vi) an emissions unit; but
- (b) does not include a writing that evidences a monetary obligation that is secured by an interest in land:

The terms “issuer”, “clearing house”, “securities depository” and “nominee” are not defined in the PPSA. The term “writing” includes the electronic recording or display of words.

One interpretation of the definition of “investment security” is that only the *direct* holder (such as a central securities depository (CSD) or its nominee) has an interest in an “investment security”.⁶⁷ If this interpretation were correct, any *indirect* holder merely has an “intangible”, the nature of which is principally determined by the contractual arrangement it has entered into with the direct holder.

We do not support this interpretation. In our view, both paragraph (a)(i)(B) – (D) of the definition of “investment security” and other provisions of the PPSA (including, in particular, section 18 (which defines “possession” and is discussed below)) indicate that a second-tier holder⁶⁸ has an interest in an “investment security”.

However, our view is that the position is considerably less clear in the case of lower- (say, third- or fourth-) tier holders.

On the one hand, there is the robust interpretation. This emphasises the definition’s recognition of the widespread commercial practice of using systems of multi-tiered

⁶⁷ The basis of this argument is that only the *underlying security* can be a “writing” of the type identified in the introductory wording in paragraph (a)(i) of the definition (i.e., something that is recognised as evidencing as share, other interest, etc. in the property of the issuer).

⁶⁸ In this opinion, we use the term **first-tier holder** to mean the direct holder of a security (such as the registered holder of registered debt securities) and the term **second-tier holder** to mean a person who derives its interest in securities directly from a first-tier holder (and so on for third- (and lower-) tier holders).

holdings and suggests that it cannot have been Parliament's intention to distinguish between second- and third- (or lower-) tier holders.

On the other hand, there is the literal interpretation. This suggests that the definition's inclusion of indirect interests is limited to those deriving their interest directly through the first-tier holder. Paragraph (a)(i)(B) – (D) only applies where the records of the clearing house, securities depository, registrar or nominee relate to the property in the introductory wording in paragraph (a)(i) (i.e., the underlying security itself). Paragraph (a)(i)(B) – (D) does *not* apply where those records relate to an indirect interest. If that interpretation were correct, these third- (and lower-) tier holders merely have an interest in an "intangible",⁶⁹ not an "investment security".

Until this position is clarified by legislation or by case law, it is advisable for LCH to analyse its position under the PPSA on the basis that either classification could be correct. The most likely practical consequence of this approach is that LCH would *both* register a financing statement in respect of the Collateral (which is the only method for perfecting a security interest in an intangible) *and* take "possession" of the Collateral (which is a method for perfecting a security interest in an investment security). This opinion considers the consequences of both interpretations.

(b) **"Intangibles"**

"Intangibles" are a residual category of "personal property". "Intangible" is defined in section 16 of the PPSA to mean:

personal property other than chattel paper, a document of title, goods, an investment security, money, or a negotiable instrument:

Cash provided to LCH by way of Collateral does not fall within any of the specified types of "personal property" that are excluded in this definition. In particular, cash (in the sense that that term is used in this opinion) is not "money" (which is defined to mean currency (e.g., bank notes)). Cash is a receivable and, therefore, for the purposes of the PPSA, an "intangible". Specifically, cash falls within the subset of "intangibles" labelled "accounts receivable".⁷⁰

Section 16 defines "account receivable" to mean:

a monetary obligation that is not evidenced by chattel paper, an investment security, or by a negotiable instrument, whether or not that obligation has been earned by performance:

(c) **"Proceeds"**

"Proceeds":

- (a) Means identifiable or traceable personal property –
 - (i) That is derived directly or indirectly from a dealing with collateral or the proceeds of collateral; and
 - (ii) In which the debtor acquires an interest; and
- (b) Includes –

⁶⁹ In this opinion, we refer to the property held by these lower-tier holders as **intangible securities**. Footnote 78 discusses a further issue relating to such lower-tier holders (in the context of "possession" of investment securities).

⁷⁰ See *Burns v The Commissioner of Inland Revenue* (2011) 25 NZTC 25, 594. Cf. *The Commissioner of Inland Revenue v Northshore Taverns Ltd (in liq.)* (2008) 23 NZTC 22,074. See also *Strategic Finance Ltd (in rec and in liq) v Bridgman* [2013] 3 NZLR 650, 671.

...

- (ii) A payment made in total or partial discharge or redemption of...an intangible or investment security...

The definition of “proceeds” requires the Relevant Clearing Member to acquire a proprietary interest in property before it constitute “proceeds”. Whether this requirement is satisfied is, we believe, a matter for the *lex situs* to determine.⁷¹

“Proceeds” will typically be cash, which LCH will likely deposit into an account containing other funds. In that case, the property may cease to be identifiable but may, under the common law tracing rules, be traceable (and, therefore, constitute “proceeds”).

“Security interest”

3.3 “Security interest” is defined in section 17(1)(a) of the PPSA to mean:

an interest in personal property created or provided for by a transaction that in substance secures payment or performance of an obligation, without regard to –

- (i) The form of the transaction; and
- (ii) The identity of the person who has title to the collateral;

3.4 In addition, and for the avoidance of doubt, section 17(3) lists a number of types of transactions to which the PPSA applies. Most importantly in the context of the LCH Agreements, the list includes “a fixed charge,...pledge,...[or] an assignment...that secures payment or performance of an obligation”. This reinforces the central concept in the section 17(1)(a) definition that it is the *substance* of the transaction that is critical. It is immaterial that the form of a transaction is, say, an absolute assignment if, in substance, it secures payment or performance of an obligation.⁷²

3.5 Returning to the section 17(1)(a) definition, do any of the LCH Agreements create a “security interest”?

3.6 There are three parts to the “security interest” definition:

- (a) the property that is the subject of the transaction must be classified as “personal property”;
- (b) the transaction must create an “interest in” that personal property (i.e., a proprietary interest in the property as opposed to a mere contractual right against the debtor); and

⁷¹ Dicey, Morris & Collins, para. 24-006. The concept of the *situs* of Collateral is discussed further in paragraph 5 below.

⁷² Section 24 restates this principle by providing that the application of the PPSA is not affected by the fact that title to collateral may be in the secured party rather than the debtor (which will be the case in an absolute assignment).

We should point out that there are those who take a contrary view and, therefore, by extension, believe that an outright transfer arrangement should *not* constitute a “security interest”. See, for example, Allan, *Guidebook to New Zealand Personal Property Securities Law* (2002), para. 2.12:

Where there is an absolute assignment no security interest is involved. When there is an assignment with an agreement to retransfer upon completion of some obligation or payment of money, then that is the type of assignment which will in substance be a security interest.

We do not share this view. There is nothing in the PPSA that suggests that a debtor must retain some proprietary interest in the collateral (akin to an equity of redemption) in order for a “security interest” to arise.

(c) the transaction must “in substance [secure] payment or performance of an obligation”.

- 3.7 The first and second parts of the definition are matters to be determined in accordance with the *lex situs* of the collateral (as these concern, in the case of the first part, the nature of the collateral and, in the case of the second part, the proprietary rights created by a transfer).⁷³
- 3.8 The third part of the definition is a matter to be determined in accordance with the governing law of the relevant LCH Agreement (as this is a matter of contractual interpretation).
- 3.9 Therefore, New Zealand law does not govern the third part of the definition (as the LCH Agreements are not governed by New Zealand law). New Zealand law also does not govern the first and second parts of the definition if the *lex situs* of the collateral is not New Zealand. However, for the purposes of this opinion, we assume that all parts of the definition would be satisfied (which would be the case if New Zealand law determined these three issues) in respect of the Deed of Charge and Clearing Membership Agreement (which encompasses the terms and conditions of the Rulebook). On that basis, each of the Deed of Charge and Clearing Membership Agreement creates a “security interest”.

4. Other relevant concepts

- 4.1 The PPSA contains other concepts that are relevant to a number of issues discussed in this opinion. We outline four of these other concepts below: possession, value, attachment and perfection.

(a) Possession

In a number of instances, the PPSA analysis for investment securities depends on whether the secured party’s security interest in those investment securities is possessory or non-possessory.

General rules for possession of investment securities

Section 18(1) of the PPSA states that:

For the purposes of this Act, a person takes possession of an investment security ... if,-

- (a) In the case of an investment security that is evidenced by a security certificate, the person takes physical possession of that certificate; or
- (b) In the case of an investment security that is traded or settled through a clearing house or securities depository, the clearing house or securities depository, as the case may be, records the interest of the person in the investment security; or
- (c) In the case of an investment security that is not evidenced by a security certificate and that is not traded or settled through a clearing house or securities depository, the records maintained by the issuer, or on behalf of the issuer, record the interest of the person in the investment security; or
- (d) In the case of an investment security that is held by a nominee, the records of the nominee record the interest of the person in the investment security.

The PPSA does not define “security certificate”, “clearing house”, “securities depository” or “nominee”.

In our view, subject to the discussion below on section 18(3):

⁷³ See Dicey, Morris & Collins, Rule 128 and footnote 71.

- (i) once LCH takes physical possession of certificates for directly held bearer securities⁷⁴ or directly held registered securities⁷⁵, LCH will have “possession” of those securities;
- (ii) once the interest of LCH in directly held dematerialised debt securities⁷⁶ is recorded in the records maintained by, or on behalf of, the issuer, LCH will have “possession” of those securities; and
- (iii) once the interest of LCH in intermediated debt securities⁷⁷ is recorded in the Intermediary’s records, LCH will have “possession” of those securities.⁷⁸

Exception to general rules for possession of investment securities

Section 18(3) of the PPSA contains an exception to the general rule for possession of investment securities, providing that:

a secured party is not in possession of collateral that is in the actual or apparent possession or control of the debtor or the debtor’s agent.

Therefore, it is arguable that LCH does not have “possession” of securities transferred to it under the LCH Agreements where either:

- (i) the Collateral is in the actual or apparent possession of the debtor’s agent and:
 - (A) LCH and the Relevant Clearing Member use a common Intermediary to hold securities; and

⁷⁴ By **directly held bearer securities** we mean securities issued in certificated bearer form and, when held by LCH as Collateral, held directly in this form by LCH (that is, not held by LCH indirectly with an Intermediary (as defined below)).

⁷⁵ By **“directly held registered securities** we mean securities issued in certificated registered form and, when held by LCH as Collateral, held directly in this form by LCH so that LCH is shown as the relevant holder in the register for such securities (that is, not held by LCH indirectly with an Intermediary).

⁷⁶ By **directly held dematerialized securities** we mean securities issued in dematerialised form and, when held by LCH as Collateral, held directly in this form by LCH so that LCH is shown as the relevant holder in the electronic register for such securities (that is, not held by LCH indirectly with an Intermediary).

⁷⁷ By **intermediated securities** we mean a form of interest in securities recorded in fungible book entry form in an account maintained by a financial intermediary (which could be a CSD or a custodian, nominee or other form of financial intermediary, in each case an **Intermediary**) in the name of LCH where such interest has been credited to the account of LCH in connection with a transfer of Collateral by the Relevant Clearing Member to LCH under the LCH Agreements.

⁷⁸ This assumes that these securities are “investment securities” for the purposes of the PPSA. If the alternative interpretation outlined in paragraph 3.2(a) of this Schedule 3 were correct (and, therefore, these securities were classified as “intangibles”), the concept of possession would be irrelevant.

However, if intermediated debt securities held by a third- (or lower-) tier holder *are* “investment securities”, a further issue arises. This is because section 18 deems a person to have possession of an investment security if the clearing house, securities depository, registrar or nominee “records the interest of *[that] person*” (our emphasis) in that investment security. Where LCH holds an interest in investment securities as a third- (or lower-) tier holder, the clearing house, securities depository, registrar or nominee to which section 18 refers will not record the interest of that person. Rather, it will record the interest of the Intermediary (or the Intermediary’s intermediary). Therefore, one interpretation of section 18 is that that person would not have “possession” of the investment securities.

That said, our view is that, if a court considered that intermediated debt securities held at the third- (or lower-) tier level were “investment securities”, the court would also likely conclude that the holder has “possession” of those “investment securities” in these circumstances. To give effect to this view, a court could regard the Intermediary as itself being a “securities depository” or “clearing house” for the purposes of section 18(1). The entry made in the records of that “securities depository” or “clearing house” would then give the indirect holder possession of the relevant investment security.

- (B) under the terms of that Intermediary's agreement with the Relevant Clearing Member, that Intermediary acts as the Relevant Clearing Member's agent; or
- (ii) the Collateral is in the control of the debtor (the Relevant Clearing Member) and the Relevant Clearing Member has the right to substitute securities without LCH's consent.

We doubt that the first argument would succeed because, in our view:

- (i) the *specific* possession rules relating to investment securities in section 18(1) should override the *general* exclusion in section 18(3);⁷⁹
- (ii) it is sensible to interpret section 18(3) as negating possession by the secured party only where the agent has possession in its capacity as the debtor's agent. That would not be the case in the circumstances we are considering; and
- (iii) the policy behind section 18(3) is to prevent third parties being misled into believing (wrongly) that property of a debtor is unencumbered (because no financing statement has been registered and the property is in the possession or control of the debtor or its agent). By contrast, in the circumstances we are considering, a third party could not reasonably be misled into believing that investment securities were unencumbered merely because the Intermediary through which they are held is an agent of the debtor.

We also doubt that the second argument would succeed. In our view, the Relevant Clearing Member does not have "control" of securities transferred to LCH by way of Collateral merely because it retains a right of substitution. The better analysis is that the Relevant Clearing Member may *gain* control of non-cash Collateral by exercising its right of substitution. But, until it exercises that right, control rests with LCH (who can deal with the securities as it sees fit in accordance with the Clearing Membership Agreement).

In our view, section 18(3) should not apply in these circumstances. Therefore, LCH has "possession" of "investment securities" once the steps set out in section 18(1) are taken. In this opinion, we assume that the relevant steps have been taken in respect of all "investment securities" subject to the LCH Agreements. In that case, LCH has a possessory security interest in those securities.

(b) **Value**

The giving of "value" by the secured party is a precondition to attachment (discussed below). It is also a precondition to a method that allows a secured party to obtain priority over all other secured parties.⁸⁰

"Value":

- (a) Means consideration that is sufficient to support a simple contract; and
- (b) Includes an antecedent debt or liability.

⁷⁹ For a discussion, and an application, of the rule *generalia specialibus non derogant* (the general does not derogate from the specific), see *McDonald v Australian Guarantee Corporation (NZ) Ltd* [1990] 1 NZLR 227 (HC).

⁸⁰ See the discussion of section 97 of the PPSA (which gives priority to a secured party taking possession of investment securities) in paragraph 6.2(c) below, under the heading "Investment securities".

The “value” given by LCH is its contractual promise under each Contract to which the Collateral relates.

(c) **Attachment**

The time of attachment of a security interest is critical to resolving a number of conflict of laws issues. Section 40(1) of the PPSA provides that a security interest attaches to collateral when:

- (i) value is given by the secured party;
- (ii) the debtor has rights in the collateral; and
- (iii) either:
 - (A) the secured party has possession of the collateral; or
 - (B) the debtor has signed, or assented to, a security agreement adequately describing the collateral.

Given our conclusion above that LCH *does* give value for the Collateral, and on the (necessary) assumption that the Relevant Clearing Member has rights in the Collateral at the outset, attachment occurs under the LCH Agreements when the Collateral is transferred to LCH or its custodian. That transfer will either give LCH “possession” of the Collateral or it will, through the description in the LCH Agreements (as the relevant “security agreements”), identify the Collateral as being subject to those agreements.⁸¹

(d) **Perfection**

Under the PPSA, there are three methods of perfecting a security interest that has attached: “possession” of the Collateral, registration of a financing statement and automatic, but temporary, perfection. We discuss each of these below. However, there are methods other than perfection that allow a secured party to obtain priority over all other secured parties. These are discussed in paragraph 6 of this Schedule 3.

Possession

We discuss the concept of “possession” in paragraph 4.1(a) above and conclude that LCH has “possession” of “investment securities” transferred to it under the LCH Agreements. However, it will not have “possession” of cash, intangible securities, or general intangibles, which (being intangibles) are incapable of actual possession and are not covered by any deemed possession rules.

Registration

Whereas possession only perfects security interests in certain types of Collateral, registration perfects security interests in all types of Collateral (including intangibles).

The registration of a financing statement is carried out electronically. Certain specified information must be contained in the financing statement (in particular, the name and address of the debtor and the secured party, the debtor’s company number and a description of the Collateral). The fee payable on registration of a financing statement is nominal (N.Z.\$10 or \$20).

⁸¹ If the transfer does not result in LCH having “possession” of the Collateral, the Relevant Clearing Member must have signed, or assented to (through written or electronic means), the security agreement.

A financing statement may be registered either before or after the LCH Agreements have been entered into or a security interest has attached. Also, a single financing statement could cover all transfers of Collateral under the LCH Agreements. Therefore, LCH would only need to register once for each Relevant Clearing Member.

It is possible to perfect a security interest both by taking possession of the Collateral (assuming it can be possessed) and by registering a financing statement. However, for the reasons given in paragraph 6 of this Schedule 3, LCH should not, in the case of “investment securities” or cash, need to perfect its security interest under *either* of these methods to obtain priority over all other secured parties.

However, if the literal interpretation we outline in paragraph 3.2(a) of this Schedule 3 is correct, and LCH is a third- (or lower-) tier holder, LCH *should* register a financing statement to perfect its security interest in intangible securities. We believe that, until the correct interpretation is judicially or statutorily confirmed, this is the prudent approach for a party in this position to adopt. However, our experience to date is that few secured parties are registering financing statements in these circumstances.

LCH should also register a financing statement to perfect its security interest in any general intangibles.

Temporary perfection

In certain circumstances, the PPSA provides for the temporary perfection of a security interest. During the period of temporary perfection, the secured party has the opportunity to re-perfect by one of the other two methods described above. If it fails to do so, it may lose priority at the end of that period.

In the context of the LCH Agreement, the most relevant application of the temporary perfection rule concerns “proceeds”. Section 45(1)(b) of the PPSA provides that a security interest in Collateral that gives rise to “proceeds” extends to those “proceeds”. Pursuant to section 47, a security interest in proceeds remains temporarily perfected for 10 working days after attachment if the security interest in the original Collateral were perfected.

5. Conflict of laws rules

5.1 The PPSA’s conflict of laws rules specify the circumstances in which New Zealand law governs the validity of a “security interest”. These rules apply despite any governing law clause in a security agreement that specifies that the laws of another jurisdiction are to determine these issues. These rules are different for “investment securities” on the one hand, and cash and other “intangibles” (such as intangible securities), on the other hand.

(a) Conflict of laws rules for “investment securities”

Section 26(1) of the PPSA states that:

[e]xcept as otherwise provided in this Act, the validity, perfection, and the effect of perfection or non-perfection of...a possessory security interest in...an investment security...is governed by the law of New Zealand if,-

(a) At the time the security interest attaches to the collateral, the collateral is situated in New Zealand; or

...

[The remaining circumstances should not be relevant for the purposes of this opinion.]

On this basis, given our conclusion in paragraph 4.1(a) above that, in respect of any “investment securities”, the Deed of Charge and Clearing Membership Agreement

create a “possessory security interest” in those “investment securities”, New Zealand law will govern the validity and perfection of that security interest if those securities are situated in New Zealand at the time of attachment. The common law conflict of laws rules for determining the *situs* of securities are as follows:

- (i) if the securities are directly held bearer debt securities, they are situated in the jurisdiction where the instrument constituting those securities is located;⁸²
- (ii) if the securities are directly held registered debt securities, they are situated in the jurisdiction where the register is located;⁸³
- (iii) if the securities are directly held dematerialised debt securities, they are situated where the records of the clearing house or securities depository are kept;⁸⁴ and
- (iv) if the securities are intermediated debt securities, the best view (although the issue is far from settled) is that they are situated where the relevant intermediary’s records are kept.⁸⁵

(b) **Conflict of laws rules for cash and other “intangibles”**

Section 30 of the PPSA states that:

The validity, perfection, and the effect of perfection or non-perfection of a security interest is governed by the law, including the conflict of laws rules, of the jurisdiction where the debtor is located when the security interest attaches, if the security interest is –

- (a) A security interest in an intangible:

We conclude in paragraph 3 above that the Deed of Charge and Clearing Membership Agreement, to the extent that they apply to cash, intangible securities, or general intangibles, create a “security interest” in “intangibles”. Therefore, the law of the jurisdiction where the debtor (i.e., the Relevant Clearing Member) is located governs validity and perfection issues in respect of a security interest over that Collateral.

⁸² Dicey, Morris & Collins, para. 22-040.

⁸³ Dicey, Morris & Collins, para. 22-044. But see the discussion in para. 22-045 relating to the overriding of this *situs* where it is not the jurisdiction of incorporation of the issuer. This approach may best reconcile the divergent views expressed by the English Court of Appeal in *Macmillan Inc. v Bishopsgate Trust (No.3)* [1996] 1 WLR 387. In that case, Staughton and Aldous LJ adopted the jurisdiction of incorporation of the issuer approach (at pages 405 and 423, respectively) and Auld LJ adopted the jurisdiction of location of the register approach (at page 411).

⁸⁴ Section 26(2) of the PPSA.

⁸⁵ Dicey, Morris & Collins, para. 22-043. We believe this represents the best view on the *situs* of intermediated debt securities. This view has overwhelming academic support: see, for example, *Oxford Colloquium on Collateral and Conflict of Laws*, Special Supplement to Butterworths Journal of International Banking and Financial Law (September 1998); Benjamin, *Interests in Securities* (2000); Austen-Peters, *Custody of Investments: Law and Practice* (2000). This view has also been accepted (albeit in a modified form) in private international law: see, for example, *The Hague Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary*, concluded on 5 July 2006.

This approach, now widely-known as the “place of the relevant intermediary approach” (or PRIMA), has the logical appeal of determining that proprietary issues in relation to interests in intermediated debt securities should be governed by the law of the place where the record of title is maintained and where, therefore, orders in respect of those securities can be enforced. PRIMA overcomes the practical difficulty, commercial inefficiency and uncertainty surrounding the alternative “look through approach” (under which the *lex situs* of intermediated debt securities is the jurisdiction where the underlying securities are located). Also, PRIMA is consistent with the statutory *situs* rule applying to directly held dematerialised debt securities (described above). It is unlikely that a New Zealand court considering the *situs* of intermediated debt securities would adopt a (common law) approach that is different to the (statutory) approach prescribed for directly held dematerialised debt securities.

Despite our views, there is no authority on this issue in New Zealand.

Section 29(a) states that, for the purposes of section 30, a debtor that is a body corporate is located in the country of its incorporation. Therefore, despite the parties' choice of governing law in the Deed of Charge and Clearing Membership Agreement, New Zealand law will govern validity and perfection issues in respect of cash, intangible securities, and general intangibles if, as we assume, the Relevant Clearing Member is incorporated in New Zealand.

However, the law applicable in this case is New Zealand law "including [its] conflict of laws rules".⁸⁶

The conflict of laws rule in New Zealand for cash is that issues of validity, perfection, and the effect of perfection or non-perfection are governed by the law of the location of the branch at which the relevant account is kept (which is the *situs* of the account).⁸⁷ Accordingly, New Zealand law will govern issues of validity and perfection if the Relevant Clearing Member's collateral account is held at a New Zealand branch of its bank.

The conflict of laws rule in New Zealand for intangible securities is that issues of validity and perfection are governed by the *lex situs*. Accordingly, New Zealand law governs issues of validity and perfection if those securities are situated in New Zealand (as to which, see paragraph 5.1(a) above).

The conflict of laws rule in New Zealand for general intangibles that constitute debts is that issues of validity and perfection are governed by the law of the jurisdiction where the debtor resides. Residence, in the case of a corporation, means the jurisdiction of incorporation, or where the corporation carries on business. Where there is more than one place of residence, and there is no promise to pay at any particular one of them, residence is the place where the debt would be paid in the ordinary course of business.⁸⁸

If the debtor relocates to another jurisdiction, section 31 sets out the circumstances in which a security interest may continue to be perfected in New Zealand.

6. Priority

- 6.1 As discussed in paragraph 5 above, the PPSA's conflict of laws rules specify the circumstances in which New Zealand law governs the "validity, perfection, and the effect of perfection or non-perfection" of a security interest. Accordingly, in matters of priority, these rules would apply to the extent that priority depends upon perfection.
- 6.2 However, as discussed below, there are methods aside from perfection that allow a secured party to obtain priority over all other security interests. It is arguable that, in these circumstances, priority matters concern "the effect of...non-perfection" of a security interest (and are, therefore, covered by the PPSA's conflict of laws rules). However, it is unclear whether a New Zealand court would uphold this view. If it did not, the common law conflict of laws rules applying to priorities would prevail. These are the same rules as apply to

⁸⁶ By contrast, there is no reference to the conflict of laws rules in section 26 (discussed above). This suggests that, in the circumstances set out in section 26(1), New Zealand *domestic* law applies: Dicey, Morris & Collins, para.s 4-005 and 4-023. However, in the circumstances set out in section 30, a *renvoi* is possible. Under a *renvoi* (or reference-back), the conflict of laws rules of, say, New Zealand refers an issue to the "law" of a foreign jurisdiction, but the conflict of laws rules of that jurisdiction would have referred the issue to the "law" of New Zealand or of a third jurisdiction.

⁸⁷ Dicey, Morris & Collins, para. 22-029.

⁸⁸ Dicey, Morris & Collins, para.s 22-026 – 22-029.

transfers (and, therefore, to the reconciliation of *competing* transfers)⁸⁹ of the underlying collateral.

Broadly, the common law conflict of laws rules provide that:

- (i) transfers of directly held bearer securities are governed by the law of the jurisdiction where the securities certificate was when it was delivered;⁹⁰
- (ii) transfers of directly held registered securities, directly held dematerialised securities⁹¹ and general debts (such as cash) are governed by the law governing the creation of those securities or that debt (i.e., the relevant proper law);⁹² and
- (iii) transfers of intermediated securities should be governed by the law of the jurisdiction where the transferor's account with its intermediary is maintained, however the issue is by no means settled.⁹³

If the conflict of laws rules of either the PPSA or the common law provide that New Zealand law governs priority issues in respect of a security interest over Collateral, the position is as described below.

(a) General rules

The basic principles in New Zealand for resolving competing priorities between creditors are that:⁹⁴

- (i) secured creditors have priority over unsecured creditors;
- (ii) a perfected security interest has priority over an unperfected security interest;
- (iii) priority between perfected security interests is determined by the order of the first to occur of registration of a financing statement or possession of the collateral; and
- (iv) priority between unperfected security interests is determined by the order of attachment.

Where the collateral that is the subject of the competing priorities is "proceeds",⁹⁵ the time of registration or possession in respect of the original collateral is also the time of registration or possession in respect of those proceeds.⁹⁶ Therefore, if LCH registers a financing statement for cash proceeds of "investment securities" within the temporary perfection period (i.e., within 10 working days of attachment), the relevant date for determining LCH's priority will be the date on which it took possession of the original collateral (being the "investment securities").

⁸⁹ Dicey, Morris & Collins, para. 24-063.

⁹⁰ Dicey, Morris & Collins, para.s 24-066.

⁹¹ While Dicey, Morris & Collins do not consider expressly transfers of directly held dematerialised debt securities, the analysis should, in principle, be the same as for directly held registered debt securities. That is, where securities are directly held, the focus should be on the method of transfer of the securities, rather than whether the securities are certificated or uncertificated. In the case of both directly held registered debt securities and directly held dematerialised debt securities, the method of transfer is by entry in the records of the issuer or of the registrar.

⁹² Dicey, Morris & Collins, para. 24-062.

⁹³ See Dicey, Morris & Collins, para. 24-071 *et seq.* for a discussion of the current state of the relevant law.

⁹⁴ Sections 36 and 66 of the PPSA.

⁹⁵ Discussed in paragraph 3.2(c) above.

⁹⁶ Section 68 of the PPSA.

(b) **Exceptions to the general rules**

As noted above, there are methods aside from perfection that allow LCH to obtain priority over all other security interests.⁹⁷ These methods differ depending on the type of Collateral involved. We discuss below the position for both “investment securities” and cash. There are no such exceptions applicable to intangible securities or general intangibles, in respect of which priority issues are determined solely under the general rules outlined above.

“Investment securities”

Section 97 of the PPSA states that:

- (1) The interest of a purchaser of an investment security has priority over a perfected security interest in the investment security if the purchaser –
 - (a) Gave value for the investment security; and
 - (b) Acquired the investment security without knowledge of the security interest; and
 - (c) Took possession of the investment security.
- (2) For the purposes of subsection (1), the purchaser of an investment security who acquired it under a transaction entered into in the ordinary course of the transferor’s business has knowledge only if the purchaser acquired the interest with knowledge that the transaction is a breach of the security agreement to which the security interest relates.

A “purchaser” is defined as a person who “purchases” personal property. “Purchase” means:

taking by sale, lease, discount, assignment, negotiation, mortgage, pledge, lien, issue, reissue, gift, or any other consensual transaction that creates an interest in personal property:

LCH is a purchaser in the context of “investment securities” transferred to it pursuant to the Clearing Membership Agreement.

To qualify for section 97(1) priority, LCH must satisfy each of the conditions set out in paragraphs (a), (b) and (c). The first and third conditions (“value” and “possession”) are discussed in paragraph 4 above (in which we conclude that LCH gives “value” for, and takes “possession” of, the “investment securities”). We discuss below the second condition – knowledge.

Section 19(1)(b) sets out what constitutes knowledge in the context of an organisation:⁹⁸

An organisation knows or has knowledge of a fact in relation to a particular transaction when –

⁹⁷ On its face, section 95 (which relates to cash and confers priority over *any* security interest) gives broader protection than section 97 (which relates to securities and confers priority over *any perfected* security interest). However, in order to avoid circularity of priority, section 97 must be read as also conferring priority over *unperfected* security interests.

⁹⁸ Section 16(1) of the PPSA defines an “organisation” to mean “any body or organisation, whether incorporated or unincorporated”. But section 19(3) specifies that “organisation” does not include a government department (in respect of which, there are special knowledge rules).

- (i) The person within the organisation with responsibility for matters to which the transaction relates has actual knowledge of the fact; or
- (ii) The organisation receives a notice stating the fact; or
- (iii) The fact is communicated to the organisation in such a way that it would have been brought to the attention of the person with responsibility for matters to which the transaction relates if the organisation had exercised reasonable care.

Section 19(2) specifies what constitutes “reasonable care”. In addition, section 20 makes it clear that registration of a financing statement is not constructive knowledge of its existence or contents to any person. In short, therefore, “knowledge” means actual knowledge.

The level of knowledge that will prevent LCH from being able to rely on section 97 depends on the circumstances of the underlying transfer of Collateral. If:

- (i) the “investment securities” are transferred in the ordinary course of the Relevant Clearing Member’s business, section 97 can be relied on unless LCH knows that the transfer is a breach of the security agreement creating the competing security interest; or
- (ii) the “investment securities” are transferred in any other circumstances, section 97 can be relied on unless LCH knows of that competing security interest.

In other words, section 97 can be relied on in a wider range of circumstances where the underlying transfer of Collateral is made in the ordinary course of the Relevant Clearing Member’s business. In this opinion, we assume an absence of knowledge by LCH of any perfected security interest in the Collateral.

Cash

Section 95(1) of the PPSA states that:

A creditor who receives payment of a debt owing by a debtor through a debtor-initiated payment has priority over a security interest in –

- (a) The funds paid;
- (b) The intangible that was the source of the payment;
- (c) A negotiable instrument used to effect the payment.

Paragraph (b) is the most relevant in this context. The “intangible” to which paragraph (b) refers is the contractual deposit arrangement that the Relevant Clearing Member has entered into with its bank.⁹⁹

The principal requirements of section 95(1) are that a “debtor” uses a “debtor-initiated payment” to pay a “debt”. We discuss each of these three requirements in turn. We also discuss the relevance of LCH’s knowledge of any competing security interest.

⁹⁹ This is distinct from the intangible that arises, or that increases in value, as a result of that payment (i.e., the contractual deposit arrangement that LCH has entered into with its bank). See *R v Preddy* [1996] AC 815 (HL) for a discussion of the distinction between these two intangibles. *Preddy* was applied by the New Zealand Court of Appeal in *R v Wilkinson* [1999] 1 NZLR 403.

“Debtor”

“Debtor” is defined in section 16 to include “[a] person who owes payment or performance of an obligation secured”. In the context of the Clearing Member Agreement the principal “obligations secured” are the obligations owed by the Relevant Clearing Member in respect of all open Contracts registered in its name.¹⁰⁰ The Relevant Clearing Member is the person that “owes payment or performance” of that “obligation secured”. Therefore, the Relevant Clearing Member is a “debtor”.

“Debtor-initiated payment”

“Debtor-initiated payment” is defined in section 95(3) to mean:

a payment made by the debtor through the use of –

- (a) A negotiable instrument; or
- (b) An electronic funds transfer; or
- (c) A debit, a transfer order, an authorisation, or a similar written payment mechanism executed by the debtor when the payment was made.

A payment made by a Relevant Clearing Member through the use of its bank or Intermediary should be a “debtor-initiated payment” under paragraph (b) or (c) of that definition.

Debt

“Debt” is not defined in the PPSA. The governing law of the LCH Agreements should determine whether an obligation to post cash Collateral in a foreign currency constitutes a debt. However, if New Zealand law determines this issue, a court would likely first consider the relative merits of the “traditional” view and the “modern” view of the role of foreign currency in these circumstances.

The traditional view is that foreign currency is *money* (and, therefore, gives rise to a debt) when it serves the classic economic function of a medium of exchange and performs the other secondary functions fulfilled by domestic currency. It is a *commodity* if it is itself the subject of commercial exchange.¹⁰¹

The modern view is that all foreign currency is “money”.¹⁰²

A review of the analysis supporting each of these views is beyond the scope of this opinion. However, in our view, a New Zealand court would *either* adopt the modern view *or* would regard the foreign currency as functioning as money (in terms of the traditional view). In either case, the court should conclude that an obligation to post cash Collateral in a foreign currency constitutes a debt.

¹⁰⁰ Regulation 20(a).

¹⁰¹ See, for example, Derham, *Set-off* (3rd ed., 2003) para.s 9.14-9.16.

¹⁰² See, for example, Wood, *English and International Set-off* (1989) p.656 and Wood, *Set-off and Netting, Derivatives, Clearing Systems* (2nd ed., 2007), para. 1-036:

There must now be very few, if any, legally developed jurisdictions which treat a foreign currency obligation as an obligation to deliver goods as opposed to money.

Knowledge

Section 95(2) states that "[s]ubsection (1) applies whether or not the creditor had knowledge of the security interest at the time of the payment". Therefore, unlike in the case of "investment securities" under section 97, in the case of cash, LCH's position is not compromised by any knowledge it has of a competing security interest. However, knowledge of a *breach* of the terms of a competing security interest *would* affect the ability of LCH to rely on section 95.¹⁰³

¹⁰³ *Stiassny v Commissioner of Inland Revenue* [2013] 1 NZLR 453 (SC).

Schedule 4

Insolvency Proceedings and Reorganisation Measures

1. Introduction

1.1 There are four Insolvency Proceedings that could apply to a Relevant Clearing Member. These are:

- (a) the liquidation regime set out in the Companies Act;
- (b) the voluntary administration regime set out in the Companies Act;
- (c) the statutory management regimes set out in:
 - (i) the CIM Act, which applies to any body of persons, whether incorporated or not, and whether incorporated or established in New Zealand or elsewhere;¹⁰⁴ and
 - (ii) the Reserve Bank Act, which applies to banks registered in New Zealand; and
- (d) the receivership regime set out in the Receiverships Act 1993.

1.2 In addition, a Relevant Clearing Member could be made subject to a Reorganisation Measure known as compromise.

1.3 We briefly outline each of these regimes below.

2. Liquidation

2.1 Liquidation is a distributive, rather than a rehabilitative, process. The Companies Act contains a set of liquidation rules that is intended to realise the assets of the company, to distribute the proceeds to the company's creditors and shareholders and, ultimately, to dissolve the company.

2.2 A company is put into liquidation by the appointment of a liquidator. Pursuant to section 241(2) of the Companies Act, a liquidator may be appointed by:

- (a) special resolution of those shareholders entitled to vote and voting on the question; or
- (b) the board of the company on the occurrence of an event specified in the constitution; or
- (c) the Court, on the application of the company, a director, a shareholder or other entitled person, a creditor of the company (including any contingent or prospective creditor), an administrator, the FMA (if the company is a financial markets participant), the Registrar [of Companies] or the Reserve Bank (if the company is a licensed insurer); or
- (d) a resolution of the creditors passed at the watershed meeting (if the company is in administration).

¹⁰⁴ Section 2(4) of the CIM Act.

3. Administration

- 3.1 Prior to the Companies Amendment Act 2006 coming into force on 1 November 2007, the only rehabilitative insolvency regime in New Zealand for viable companies was the compromises regime (see below). For a number of reasons (including, in particular, the need to obtain creditor consent), this had proved to be a difficult regime to apply in practice. Therefore, Parliament enacted an alternative regime to encourage business rehabilitation, based on the voluntary administration model adopted by Australia in 1992.
- 3.2 The administration of a company begins when an administrator is appointed by:
- (a) board resolution; or
 - (b) a liquidator; or
 - (c) a secured creditor holding a charge over all, or substantially all, of the company's property where that charge has become enforceable; or
 - (d) the High Court, on the application of a creditor, a liquidator, the FMA (if the company is a financial markets participant) or the Registrar of Companies.¹⁰⁵
- 3.3 The appointment of an administrator has three main consequences. First, it vests control of the company's business in the administrator. Secondly, it triggers obligations on the administrator to hold various creditors' meetings to try to seek a consensus on the future of the company. Thirdly, it imposes a stay on certain creditor actions (similar to the moratorium imposed in a statutory management, as discussed below). For example, while a company remains in administration, in the absence of administrator consent or a court order:
- (a) a transaction or dealing that affects the company's property is void;
 - (b) a person may not enforce a charge over the company's property, except for:
 - (i) a chargeholder having a charge over all, or substantially all, of the company's property who begins enforcing the charge no later than the 10th working day after the commencement of the administration; or
 - (ii) *any* chargeholder who begins enforcing its charge prior to the commencement of the administration;
 - (c) the owner or lessor of property occupied or used by the company may not repossess that property (unless repossession began prior to the commencement of the administration); and
 - (d) court proceedings or any enforcement process against the company or any of its property may not begin or continue.
- 3.4 Administration is intended to be a relatively short-term measure that (by and large) freezes the company's financial position while the administrator and the creditors negotiate the company's future. The administration of a company ends either when the negotiations have been successful (in which case, a "deed of company arrangement" is entered into)¹⁰⁶ or when the statutory timeframe expires without resolution. Other steps, such as the appointment of a liquidator, can also end an administration.

¹⁰⁵ Section 239H(1) of the Companies Act.

¹⁰⁶ A deed of company arrangement must be approved by a majority in number representing 75% in value of creditors voting.

4. Statutory management

- 4.1 By contrast, statutory management is a more rehabilitative process. In broad terms, making a party subject to statutory management in New Zealand creates a moratorium in relation to that party's affairs.¹⁰⁷ The effect of that moratorium is outlined below.
- 4.2 A party is made subject to statutory management by way of a declaration to that effect in the form of an Order-in-Council signed by the Governor-General:
- (a) in the case of the CIM Act, on the advice of the Minister of Justice given in accordance with a recommendation of the FMA; or
 - (b) in the case of the Reserve Bank Act, on the advice of the responsible Minister given in accordance with a recommendation of Reserve Bank.
- 4.3 The statutory management moratorium provides that no person may, among other things:
- (a) take any action or other proceedings against the party made subject to statutory management; or
 - (b) apply or resolve to put that party into liquidation; or
 - (c) enforce any security interest it may have over that party's property (for example, margin); or
 - (d) exercise any right of set-off against that party.
- 4.4 In addition, the statutory manager is able, "notwithstanding the terms of any contract, [to] suspend in whole or in part, ...the payment of any debt, or the discharge of any obligation".¹⁰⁸ This suspension expressly does not constitute a breach or repudiation of the relevant contract with the result that the other party cannot cancel it for breach or repudiation.¹⁰⁹

5. Receivership

- 5.1 A receiver, manager or receiver and manager of a New Zealand company's affairs may be appointed either by the terms of a contract (typically, a contract granting a security interest) or by a court under the Receiverships Act. A receiver is generally appointed to manage all or substantially all of the company's affairs.
- 5.2 The options available to a receiver include:
- (a) selling the assets of the company in respect of which the receiver is appointed; or
 - (b) continuing to run the business of the company as a going concern; or
 - (c) putting the company into liquidation.

6. Compromises

- 6.1 The Companies Act contains a statutory procedure by which a company may enter into a compromise with its creditors. For this purpose, a "compromise" is defined in section 227 of the Companies Act to include:

¹⁰⁷ Section 42 of the CIM Act. The equivalent provision in the Reserve Bank Act is section 122.

¹⁰⁸ Section 44(1) of the CIM Act; section 127(1) of the Reserve Bank Act.

¹⁰⁹ Section 44(2) of the CIM Act; section 127(2) of the Reserve Bank Act.

a compromise –

- (a) Cancelling all or part of a debt of the company; or
- (b) Varying the rights of its creditors or the terms of a debt; or
- (c) Relating to an alteration of a company's constitution that affects the likelihood of the company being able to pay a debt.

6.2 A compromise proposal may be initiated by the board of directors of the company, a receiver, a liquidator or, with the leave of the court, any creditor or shareholder of the company where any of those persons has reason to believe that the company is or will be unable to pay its debts.¹¹⁰ Also, the court may, under section 236 of the Companies Act, on the application of a company or any shareholder or creditor of the company, order that a compromise is binding on the company and on such other persons as the court specifies.

6.3 However, before any compromise may be approved, certain procedures are required to be followed (except in the case of a compromise ordered by the court pursuant to section 236), including that the party proposing the compromise must give to each known "creditor" of the company, the company itself and any liquidator or receiver and deliver to the Registrar of Companies for registration, the following documents:

- (a) notice in accordance with the requirements in the Companies Act stating that a meeting of creditors is to be held;
- (b) a statement setting out, among other things, the terms of the proposed compromise and explaining that the proposed compromise and any amendment to it at a meeting of creditors will be binding on all creditors if approved in accordance with the Companies Act; and
- (c) a list of creditors known to the proponent who would be affected by the proposed compromise, together with amounts owing or estimated to be owing to each of them and their voting rights at the meeting of creditors.

6.4 A compromise only becomes binding if a majority in number representing at least 75% in value of the creditors, or a class of creditors, voting on the matter votes in favour of the compromise. A compromise is binding on the company and on all creditors to whom notice of the proposal is given.

¹¹⁰ Section 228(1) of the Companies Act.

Schedule 5

Netting Acts

1. Summary of the Netting Acts

1.1 On 26 April 1999, specific netting legislation came into force in New Zealand. The legislation is split into four statutes: the Companies Amendment Act 1999, the Corporations (Investigation and Management) Amendment Act 1999, the Reserve Bank of New Zealand Amendment Act 1999 and the Insolvency Amendment Act 1999. The first three of these four statutes, together with the Companies Amendment Act 2006,¹¹¹ (the **Netting Acts**) are relevant for the purposes of this opinion. The fourth statute deals with netting agreements entered into by individuals. It is, therefore, not relevant for the purposes of this opinion.

1.2 Each Netting Act amends its underlying principal Act to provide expressly for the enforceability of “netting agreements” in the context of the relevant insolvency regime.

2. “Netting agreements”

2.1 “Netting agreements” are of two types: “bilateral netting agreements” and “recognised multilateral netting agreements”. Only the first type is relevant for the purposes of this opinion.

A “bilateral netting agreement” is defined in section 310A of the Companies Act as:

an agreement that provides, in respect of transactions between 2 persons to which the agreement applies, -

- (a) That on the occurrence of an event specified in the agreement, all or any of those transactions must (or may, at the option of a party) be terminated and -
 - (i) An account taken of all money due between the parties in respect of the terminated transactions; and
 - (ii) All obligations in respect of that money satisfied by payment of the net amount due from or on behalf of the party having a net debit to or on behalf of the party having a net credit; or
- (b) That each transaction is to be debited or credited to an account with the effect that the rights and obligations of each party that existed in respect of the relevant account prior to the transaction are extinguished and replaced by rights and obligations in respect of the net debit due on the relevant account after taking into account that transaction; or
- (c) That amounts payable by each party to the other party are to be paid or satisfied by payment of the net amount of those obligations by the party having a net debit to the party having a net credit; -

but does not include any bilateral netting agreement that is part of a multilateral netting agreement.

2.2 In broad terms, a “bilateral netting agreement” is an agreement between two persons that provides for any of three different types of netting: close-out netting, netting by novation or payments netting. In contrast to the equivalent legislation in a number of other jurisdictions, a “netting agreement” does not need to be entered into between particular types of counterparties or to relate to particular types of transactions in order to qualify for protection under the Netting Acts.

¹¹¹ The Companies Amendment Act 2006 introduced the administration regime outlined in Schedule 4 above. At the same time, that Act also adopted netting rules (consistent with those adopted in 1999) to apply to a company in administration.

2.3 The effect of the Netting Acts is that the contractual rights of netting or set-off contained in a “netting agreement” operate in accordance with their terms in the liquidation, statutory management or administration of a Relevant Clearing Member. To this extent, those rights override the general insolvency rules that otherwise apply mandatorily in these circumstances.

3. Application of the Netting Acts to the LCH Agreements

3.1 In principle, whether an agreement constitutes a “bilateral netting agreement” should, under New Zealand’s conflict of laws rules, be determined by its governing law. We assume in this opinion that, under English law, the Clearing Membership Agreement (through, in particular, Rules 6 and 8 of the Default Rules) is a “bilateral netting agreement” in terms of section 310A of the Companies Act.

3.2 However, it is also possible that a New Zealand court could conclude that the Netting Acts contain mandatory insolvency rules that should be interpreted in accordance with New Zealand law. In that regard, the Clearing Membership Agreement is, as a matter of New Zealand law, a “bilateral netting agreement”. That is, the Clearing Membership Agreement satisfies the requirements for a “bilateral netting agreement” (specifically, through qualifying under either paragraph (a) and/or paragraph (b) of the definition of that term).

Appendix A
Clearing Membership Agreement



CLEARING MEMBERSHIP AGREEMENT

DATED

LCH.CLEARNET LIMITED

and

("the Firm")

Address of the Firm

THIS AGREEMENT is made on the date stated above

BETWEEN the Firm and LCH.CLEARNET LIMITED ("the Clearing House"), whose registered office is at Aldgate House, 33 Aldgate High Street, London, EC3N 1EA.

WHEREAS:

- A The Clearing House is experienced in carrying on the business of a clearing house and undertakes with each Clearing Member the performance of contracts registered in its name in accordance with the Rulebook;
- B The Clearing House has been appointed by certain Exchanges to provide central counterparty and other services in accordance with the terms and conditions of the Rulebook and certain agreements entered into between the Clearing House and such Exchanges;
- C The Clearing House also provides central counterparty and other services to participants in certain over-the-counter ("OTC") markets in accordance with the terms of this Agreement and the Rulebook;
- D The Firm desires to be admitted as a Clearing Member of the Clearing House to clear certain categories of Contract agreed by The Clearing House with the Firm and, the Clearing House having determined on the basis inter alia of the information supplied to it by the Firm that the Firm satisfies for the time being the relevant Criteria for Admission, the Clearing House agrees to admit the Firm as a Clearing Member subject to the terms and conditions of this Agreement.

NOW IT IS HEREBY AGREED as follows:-

1 Interpretation and Scope of Agreement

1.1. Unless otherwise expressly stated, in this Agreement:

- (a) "Cash Cover" means cover for margin (within the meaning of that term in the "Definitions" section of the Rulebook) provided in the form of a cash deposit with the Clearing House;
- (b) "Clearing Member" means a Person who has been admitted to membership of the Clearing House and whose membership has not terminated;
- (c) "Contract" means a contract or transaction eligible for registration in the Firm's name by the Clearing House in accordance with the Rulebook;
- (d) "Contribution" and "Contribution to the Default Fund" mean the sums of cash deposited by the Firm as cover in respect of the Firm's obligation to indemnify the Clearing House as provided by clause 9 of this Agreement and the Default Rules;
- (e) "Criteria for Admission" means criteria set out in one or more documents published from time to time by the Clearing House, being criteria to be satisfied by an applicant for admission as a Clearing Member in respect of the Designated Contracts which the applicant wishes to clear with the Clearing House;
- (f) "Default Fund" means the fund established under the Default Rules of the Clearing House to which the Clearing Member is required to contribute by virtue of clause 9 of this Agreement;
- (g) [DELETED]

- (h) "Default Notice" means a notice issued by the Clearing House in accordance with the Default Rules in respect of a Clearing Member who is or is likely to become unable to meet its obligations in respect of one or more Contracts;
- (i) "Default Rules" means that part of the Rulebook having effect in accordance with Part IV of the Financial Services and Market Act 2000 (Recognition Requirements for Investment Exchange and Clearing Houses) Regulations 2001 to provide for action to be taken in respect of a Clearing Member subject to a Default Notice;
- (j) "Designated Contract" has the meaning given to it in clause 2.1;
- (k) "Exchange" means an organisation responsible for administering a market with which the Clearing House has an agreement for the provision of central counterparty and other services to Clearing Members;
- (l) "Exchange Contract" means any contract which an Exchange has adopted and authorised Exchange Members to trade in under its Exchange Rules and in respect of which the Clearing House has agreed to provide central counterparty and other services;
- (m) "Exchange Member" means any person (by whatever name called) being a member of, or participant in, a Market pursuant to Exchange Rules;
- (n) "Exchange Rules" means any of the regulations, rules and administrative procedures or contractual arrangements for the time being and from time to time governing the operation of a Market administered by an Exchange and includes, without prejudice to the generality of the foregoing, any regulations made by the directors of an Exchange or by any committee established under the Rules, and, save where the context otherwise requires, includes Exchange Contracts, and the Rulebook;
- (o) "Rulebook" means the Clearing House's General Regulations, Default Rules, Settlement Finality Regulations and Procedures and such other rules of the Clearing House as published and amended from time to time;
- (p) "Market" means a futures, options, forward, stock or other market, administered by an Exchange, or an OTC market, in respect of which the Clearing House has agreed with such Exchange or, in respect of an OTC market, with one or more participants in that market, to provide central counterparty and related services on the terms of the Rulebook and in the case of an Exchange, pursuant to the terms of any agreement entered into with the Exchange;
- (q) "Person" includes any firm, company, corporation, body, association or partnership (whether or not having separate legal personality) or any combination of the foregoing;
- (r) "Procedures" means that part of the Rulebook by that name;
- (s) "Registered Contract" means a contract registered in the Firm's name by the Clearing House in accordance with the Rulebook;

- 1.2. (a) References to "the parties" are references to the parties hereto, and "party" shall be construed accordingly;
- (b) References herein to a clause are to a clause hereof and clause headings are for ease of reference only;
- (c) Unless the context otherwise requires, words (including defined terms) denoting the singular shall include the plural and vice versa;

- (d) References to writing include typing, printing, lithography, photography, facsimile transmission and other modes of representing or reproducing words in a visible form; and
- (e) References herein to statutes, statutory instruments, the Rulebook, or provisions thereof are to those statutes, statutory instruments, Rulebook or provisions thereof as amended, modified or replaced from time to time.

1.3 This Agreement, the terms of any other agreement to which the Clearing House and the Clearing Member are party which relates to the provision of central counterparty and other services by the Clearing House, the terms of, and applicable to, each and every Registered Contract, the Rulebook and all amendments to any of the foregoing shall together constitute a single agreement between the Clearing House and the Clearing Member and both parties acknowledge that all Registered Contracts are entered into in reliance upon the fact that all such items constitute a single agreement between the parties.

1.4 A person who is not a party to this Agreement shall have no rights under or in respect of this Agreement.

2 Clearing Membership

2.1. The Firm is hereby admitted as a Clearing Member on the terms set out in this Agreement. The Firm shall be eligible to clear such categories of Contract (each a "Designated Contract") as the Clearing House shall from time to time notify to the Firm.

2.2. The Firm warrants that the information supplied by the Firm to the Clearing House in connection with the enquiry conducted by the Clearing House to determine whether the Firm satisfies for the time being the Criteria for Admission was and is at the date of this Agreement true and accurate in all material respects.

2.3. The Firm will ensure that it will at all times satisfy the Criteria for Admission. If at any time it has reason to believe that it no longer satisfies or may cease to satisfy any of such criteria the Firm shall immediately notify the Clearing House of the circumstances.

2.4. The Firm shall give written notice forthwith to the Clearing House of the occurrence of any of the following of which it is aware:-

- (a) the presentation of a petition or passing of any resolution for the bankruptcy or winding-up of, or for an administration order in respect of, the Firm or of a subsidiary or holding company of the Firm;
- (b) the appointment of a receiver, administrative receiver, administrator or trustee of the estate of the Firm;
- (c) the making of a composition or arrangement with creditors of the Firm or any order or proposal in connection therewith;
- (d) where the Firm is a partnership, an application to dissolve the partnership, the presentation of a petition to wind up the partnership, or any other event which has the effect of dissolving the partnership;
- (e) where the Firm is a registered company, the dissolution of the Firm or the striking-off of the Firm's name from the register of companies;
- (f) any step analogous to those mentioned in paragraphs (a) to (e) of this clause 2.4 is taken in respect of such persons as are referred to in those respective paragraphs in any jurisdiction;
- (g) the granting, withdrawal or refusal of an application for, or the revocation of any licence or authorisation to carry on investment, banking or insurance business in any country;

- (h) the granting, withdrawal or refusal of an application for, or the revocation of, a license or authorisation by the Financial Conduct Authority, the Prudential Regulation Authority or membership of any self-regulating organisation, recognised or overseas investment exchange or clearing house (other than the Clearing House) under the Financial Services and Markets Act 2000 or any other body or authority which exercises a regulatory or supervisory function under the laws of the United Kingdom or any other state;
- (i) the appointment of inspectors by a statutory or other regulatory authority to investigate the affairs of the Firm (other than an inspection of a purely routine and regular nature);
- (j) the imposition of any disciplinary measures or sanctions (or similar measures) on the Firm in relation to its investment or other business by any Exchange, regulatory or supervisory authority;
- (k) the entering of any judgment against the Firm under Section 150 of the Financial Services and Markets Act 2000;
- (l) the conviction of the Firm for any offence under legislation relating to banking or other financial services, building societies, companies, credit unions, consumer credit, friendly societies, insolvency, insurance and industrial and provident societies or for any offence involving fraud or other dishonesty;
- (m) the conviction of the Firm, or any subsidiary or holding company of the Firm for any offence relating to money laundering, or the entering of judgment or the making of any order against the Firm in any civil action or matter relating to money laundering;
- (n) any enforcement proceedings taken or order made in connection with any judgement (other than an arbitration award or judgement in respect of the same) against the Firm; and
- (o) any arrangement entered into by the Firm with any other Clearing Member relating to the provision of central counterparty and associated services by the Clearing House of Contracts or transactions entered into by the Firm after the effective date of termination of this Agreement.

2.5. 2.5 The Firm shall give written notice forthwith to the Clearing House of any person becoming or ceasing to be a director of or a partner in the Firm or of the occurrence of any of the following in relation to a director of or a partner in the Firm, if aware of the same:-

- (a) the occurrence of any event specified in clause 2.4 (insofar as it is capable of materially affecting him); or
- (b) any disqualification order under the Company Directors Disqualification Act 1986 or equivalent order in overseas jurisdictions.

2.6. The Firm shall give written notice forthwith to the Clearing House of any change in its name, the address of its principal place of business, registered office or UK office.

2.7. The Firm shall give written notice to the Clearing House forthwith upon its becoming aware that any person is to become or cease to be, or has become or ceased to be, a controller of the Firm, and shall in relation to any person becoming a controller of the Firm state:-

- (a) the controller's name, principal business and address;
- (b) the date of the change or proposed change.

In this clause and in clause 2.9 "controller" means a person entitled to exercise or control the exercise of 20 per cent or more of the voting power in the Firm.

- 2.8. The Firm shall give written notice forthwith to the Clearing House of any change in its business which affects the Firm's ability to perform its obligations under this Agreement.
- 2.9. Where the Clearing House receives notification pursuant to any of clauses 2.3 to 2.8, or the Clearing House reasonably suspects that the Firm may no longer satisfy some or all of the Criteria for Admission or the criteria for clearing a Designated Contract, the Clearing House shall be entitled in its absolute discretion to call for information of whatsoever nature in order to determine whether the Firm continues to satisfy the Criteria for Admission or the criteria for clearing a Designated Contract. Without prejudice to the foregoing, the Clearing House may at any time call for information relating to the affairs (including the ownership) of any controller of the Firm or any person who is to become a controller of the Firm. The Firm shall forthwith on demand supply to the Clearing House information called for under this clause and shall ensure that such information is true and accurate in all respects.
- 2.10. The Firm undertakes to abide by the Rulebook and undertakes at all times to comply with other provisions of Exchange Rules so far as they apply to the Firm.
- 2.11. The Firm undertakes that at all times, to the extent the Firm is required under any applicable law to be authorised, licensed or approved in relation to activities undertaken by it, it shall be so authorised, licensed or approved.
- 2.12. The Firm agrees that in respect of any Contract for which central counterparty services are to be provided to the Firm by the Clearing House in accordance with the Rulebook, including, but not limited to, any contract made by the Firm under Exchange Rules on the floor of a Market (or through a Market's automated trading system) or otherwise, whether with a member of that Market or with a client or with any other person, and including any Contract entered into in an OTC market, the Firm shall contract as principal and not as agent.
- 2.13. The Firm shall furnish financial information to the Clearing House in accordance with the requirements of the Rulebook or such other requirements as the Clearing House may from time to time prescribe.
- 2.14. The Firm undertakes that, in its terms of business with its clients (being clients in respect of whom the Firm is subject to any regulations made pursuant to rules and/or legislation applicable to the Firm with respect to the safeguarding or segregation of clients' money):
- (a) where it is subject to Exchange Rules, it will at all times include a stipulation that contracts made under Exchange Rules with or for them shall be subject to Exchange Rules (including the Rulebook); and
 - (b) that money of such clients in the possession of the Clearing House may be dealt with by the Clearing House in accordance with the Rulebook without exception.
- 2.15. Without prejudice to clause 2.14 the Firm undertakes that its dealings with all its clients or counterparties shall be arranged so as to comply with the requirement that the Firm deals with the Clearing House as principal, and that all sums deposited with the Clearing House by way of Cash Cover (including the Firm's Contribution to the Default Fund) shall be deposited unencumbered and by the Firm acting as sole principal and as legal and beneficial owner.
- 2.16. The Firm undertakes not to assign, charge or subject to any other form of security, whether purporting to rank in priority over, *pari passu* with or subsequent to the rights of the Clearing House, any Cash Cover provided to the Clearing House, including its entitlement to repayment of its Contribution to the Default Fund or any part of it. Any purported charge, assignment or encumbrance (whether by way of security or otherwise) of Cash Cover provided to the Clearing House shall be void. The Firm shall not otherwise encumber (or seek to encumber) any Cash Cover provided to the Clearing House.

3 Remuneration

- 3.1. The Clearing House shall be entitled to charge the Firm such fees, charges, levies and other dues, on such events, and calculated in accordance with such scales and methods, as are for the time prescribed by the Clearing House and, where relevant, for Exchange Contracts, after consultation with the relevant Exchange.

- 3.2. The Clearing House shall give the Firm not less than fourteen days' notice of any increase in such fees, charges, levies or other dues.

4 Facilities Provided by the Clearing House

4.1. Provision of Central Counterparty Services

- (a) Details of all Contracts to be registered by the Clearing House in the name of the Firm and in respect of which central counterparty services are to be provided shall be provided to the Clearing House in accordance with the Rulebook and any other agreement entered into between the Clearing House and the Firm.
- (b) Provided that a Contract meets the criteria for registration of that Contract in the name of the Firm and is a Designated Contract, and subject to the Rulebook, the Clearing House shall enter into a Registered Contract with the Firm in respect thereof. Each such Contract shall be registered in accordance with the Rulebook and the Clearing House shall perform its obligations in respect of all Registered Contracts in accordance with this Agreement and the Rulebook.

4.2. Maintenance of Records

The Clearing House agrees that for a period of ten years after termination of a Registered Contract it shall maintain records thereof. The Clearing House may make a reasonable charge to the Firm for the production of any such records more than three months after registration.

4.3. Information

The Clearing House will provide to the Firm such information at such times as is provided for by the Rulebook.

4.4. Accounts

The Clearing House agrees to establish and maintain one or more accounts for the Firm in accordance with the Rulebook. Accounts will be opened and kept by the Clearing House in such manner as will not prevent the Firm from complying with requirements of any regulations made pursuant to rules and/or legislation applicable to the Firm with respect to the safeguarding or segregation of clients' money and the rules of such regulatory organisation as the Firm may be subject to in respect of their cleared business.

5 Default

In the event of the Firm appearing to the Clearing House to be unable, or to be likely to become unable, to meet any obligation in respect of one or more Registered Contracts, or failing to observe any other financial or contractual obligation under the Rulebook, the Clearing House shall be entitled to take all or any of the steps set out in that regard in the Rulebook, including (but not limited to) the liquidation of all or any of the Registered Contracts.

6 Disclosure of Information

The Firm agrees that the Clearing House shall have authority to disclose any information of whatsoever nature concerning the Firm to such persons as is provided for by the Rulebook.

7 Partnership

If the Firm is a partnership, the liability of each partner in the Firm hereunder and under any Registered Contract shall be joint and several and, notwithstanding an event which would by operation of law give rise to the dissolution of the partnership, or entitle a partner to seek an order to dissolve the partnership, including, but not limited to, the event of the death, bankruptcy, winding-up or dissolution of any such partner, the respective obligations of the Clearing House and all other partners shall remain in full force and effect. If the Firm is a partnership, the Firm undertakes that if any new partner joins the Firm, the Firm shall procure that such new partner becomes jointly and severally liable alongside existing partners in respect of obligations of the Firm to the Clearing House outstanding at the date of such new partner's accession to the Firm.

8 Term

- 8.1. Subject to clause 8.3 either party (provided, in the case of the Firm, that the Clearing House has not issued a Default Notice in respect of the Firm) may terminate this Agreement by giving to the other party notice in writing, such notice to specify the effective date of termination ("the termination date") which shall be a business day not less than three months after the date of the notice, and this Agreement shall, subject to clause 8.2(b), terminate on the termination date. By the close of business on the termination date the Firm shall ensure that all Registered Contracts in the Firm's name have been closed-out or transferred so that there are no open Registered Contracts to which the firm is party at the end of the termination date.
- 8.2. If, under clause 8.1, the Firm has not closed out or transferred all Registered Contracts by the set termination date the Clearing House shall, at its sole discretion, be entitled to:
- (a) liquidate any such Registered Contracts in accordance with the Rulebook; and
 - (b) require that the Firm remains a member of the Clearing House until such time as there are no Registered Contracts in existence to which the Firm is a party and the effective date of termination of this Agreement shall be postponed until such time.
- 8.3. If the Firm is in breach of or in default under any term of this Agreement or the Rulebook, or if the Clearing House has issued a Default Notice in respect of the Firm, or if the Clearing House reasonably determines that the Firm no longer satisfies the Criteria for Admission as a Clearing Member, the Clearing House may in its absolute discretion terminate this Agreement in writing either summarily or by notice as follows.

Any termination by notice under this clause 8.3 may take effect (subject as follows) on the expiry of 30 days or such longer period as may be specified in the notice. A notice given by the Clearing House under this clause may at the Clearing House's discretion allow the Firm a specified period in which to remedy the breach or default or to satisfy the Criteria for Admission as the case may be, and may specify what is to be done to that end, and may provide that if the same is done to the satisfaction of the Clearing House within that period the termination of this Agreement shall not take effect; and if this Agreement has terminated after the Clearing House has allowed the Firm such a period for remedy or satisfaction, the Clearing House shall then notify the Firm of the fact of termination. The Clearing House may, if the Clearing House has issued a Default Notice in respect of the Firm immediately, and in any other case after the effective date of termination, take such other action as it deems expedient in its absolute discretion to protect itself or any other Clearing Member including, without limitation, the liquidation of Registered Contracts but without prejudice to its own rights in respect of such contracts.

- 8.4. Upon the termination of this Agreement for whatever reason the Firm shall unless otherwise agreed cease to be a Clearing Member.

9 Default Fund

- 9.1. In this clause the term "Excess Loss" bears the meaning ascribed to it in the Rulebook.
- 9.2. The Firm, as primary obligor and not surety, hereby indemnifies the Clearing House in respect of any Excess Loss, and undertakes to deposit cash with the Clearing House as collateral for its obligations in respect of such indemnity, in accordance in each case with the Default Rules.

- 9.3. The Firm shall, in accordance with the Default Rules, continue to be liable to indemnify the Clearing House in respect of any Excess Loss arising upon any default occurring before the effective date of termination of this Agreement. Subject thereto, the indemnity hereby given shall cease to have effect on the effective date of termination of this Agreement, unless a Default Notice is issued by the Clearing House in respect of the Firm, in which case the indemnity hereby given shall cease to have effect after the date three months after the date of issue of such Default Notice.
- 9.4. Save as provided expressly by the Default Rules, the Firm shall not be entitled to exercise any right of subrogation in respect of any sum applied in satisfaction of its obligations to the Clearing House under this clause 9.

10 Force Majeure

Neither party shall be liable for any failure in performance of this Agreement if such failure arises out of causes beyond its control. Such causes may include, but are not limited to, acts of God or the public enemy, acts of civil or military authority, fire, flood, labour dispute (but excluding strikes, lock-outs and labour disputes involving the employees of the party intending to rely on this clause or its sub-contractors), unavailability or restriction of computer or data processing facilities or of energy supplies, communications systems failure, failure of a common depository, clearing system or settlement system, riot or war.

11 The Rulebook

In the event of conflict between the Rulebook and the provisions of this Agreement the Rulebook shall prevail.

12 Notices

- 12.1. Any notice or communication to be made under or in connection with this Agreement shall be made in writing addressed to the party to whom such notice or communication is to be given; save that a notice or communication of an urgent nature shall be given or made orally and as soon as reasonably practicable thereafter confirmed in writing in conformity hereto. A notice may be delivered personally or sent by post to the address of that party stated in this Agreement, or to such other address as may have been notified by that party in accordance herewith.
- 12.2. Where a notice is sent by the Clearing House by post it shall be deemed delivered 24 hours after being deposited in the post first-class postage prepaid in an envelope addressed to the party to whom it is to be given in conformity to clause 12.1, or in the case of international mail, on the fourth business day thereafter. In all other cases notices shall be deemed delivered when actually received.

13 Law

- 13.1. This Agreement shall be governed by and construed in accordance with the laws of England and Wales. The parties irrevocably agree that the courts of England and Wales shall have exclusive jurisdiction to hear and determine any action or dispute which may arise herefrom. The Clearing House and the Firm each irrevocably submits to such jurisdiction and to waive any objection which it might otherwise have to such courts being a convenient and appropriate forum.
- 13.2. The Firm irrevocably waives, with respect to itself and its revenues and assets all immunity on the grounds of sovereignty or other similar grounds from suit, jurisdiction of any court, relief by way of injunction, order for specific performance or for recovery of property, attachment of its assets (whether before or after judgement) and execution or enforcement of any judgement to which it or its revenues or assets might otherwise be entitled in any proceedings in the courts of any jurisdiction and irrevocably agrees that it will not claim any such immunity in any proceedings.

14 Service of Process

Without prejudice to any other mode of service, and subject to its right to change its agent for the purposes of this Clause on 30 days' written notice to the Clearing House, the Firm (other than where it is incorporated in England and Wales or otherwise has an office in England and Wales) appoints, as its agent for service of process relating to any proceedings

before the courts of England and Wales in connection with the Firm the person in London as notified to the Clearing House in writing with the application for admission.



IN WITNESS whereof the parties hereto have caused this Agreement to be signed by their duly authorised representatives the day and year first before written.

(Signature)

(Print Name and Title)

for THE FIRM

(Signature)

(Print Name and Title)

for THE FIRM

(Signature)

(Print Name and Title)

for LCH.CLEARNET LIMITED

(Signature)

(Print Name and Title)

for LCH.CLEARNET LIMITED

LCH.CLEARNET LIMITED

Aldgate House 33 Aldgate High Street London EC3N 1EA

Tel: +44 (0)20 7426 7000 Fax: +44 (0)20 7426 7001

Internet: <http://www.lchclearnet.com>

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Appendix B
Deed of Charge

A company whether incorporated in England and Wales or an overseas company.

CHARGE BY CLEARING MEMBER

CHARGE SECURING OWN OBLIGATIONS

Date of Execution: _____

Date of Delivery:
(to be completed by LCH.Clearnet Limited) _____

Name and Address of Chargor:

Clearing Membership Agreement Date: _____

Chargor's Account: _____

THIS DEED made on the date above-stated **BETWEEN THE ABOVE-NAMED CHARGOR** ("the Chargor") and **LCH.CLEARNET LIMITED** ("the Clearing House")

WITNESSES as follows :

1. **Interpretation**

- (1) Any reference herein to any statute or to any provisions of any statute shall be construed as a reference to any statutory modification or re-enactment thereof and to any regulations or orders made thereunder and from time to time in force.
- (2) The clause headings shall not affect the construction hereof.
- (3) A person who is not a party to this Deed has no right under the Contracts (Rights of Third Parties) Act 1999 to enforce or to enjoy the benefit of any term of this Deed.

2. **The Secured Obligations**

- (1) The Chargor shall pay to the Clearing House all monies (including settlement costs, interest and other charges) which now are or at any time hereafter may be or become due or owing by the Chargor to the Clearing House on the account identified above (or, but only if no account is identified, on all accounts of the Chargor with the Clearing House) and discharge all other liabilities of the Chargor (whether actual or contingent, now existing or hereafter incurred) to the Clearing House on the said account (or, if no account is identified, on all accounts of the Chargor with the Clearing House) in each case when due in accordance with the Clearing Membership Agreement and the Clearing House's Rulebook referred to therein (the Clearing Membership Agreement and the Clearing House's Rulebook as from time to time amended, renewed or supplemented being hereinafter referred to as "**the Agreement**") or, if the Agreement does not specify a time for such payment or discharge, promptly following demand by the Clearing House.
- (2) In the event that the Chargor fails to comply with sub-paragraph (1), the Chargor shall pay interest accruing from the date of demand on the monies so demanded and on the amount of other liabilities at the rate provided for in the Agreement or, in the event of no such rate having been agreed, at a rate determined by the Clearing House (the rate so agreed or determined to apply after as well as before any judgment), such interest to be paid upon demand of the Clearing House in accordance with its usual practice and to be compounded with rests in the event of its not being duly and punctually paid.
- (3) The monies, other liabilities, interest and other charges referred to in paragraph (1) of this clause, the interest referred to in sub-paragraph (2) of this clause and all other monies and liabilities payable or to be discharged by the Chargor under

or pursuant to any other provision of this Deed are hereinafter collectively referred to as "the Secured Obligations".

2A. Custody of Collateral

- (1) The Chargor shall, in accordance with the Procedures, transfer collateral to the Clearing House. Where such collateral takes the form of Securities, the Clearing House shall hold such Securities as custodian for the Chargor, subject to the terms of this Deed.
- (2) From time to time, in accordance with the Procedures and in the context of a transfer of one or more contracts and related cover from one member of the Clearing House to the Chargor at the request of a client of that other member or the Chargor, the Clearing House shall designate that certain Securities which it previously held as custodian for a third party are instead held by the Clearing House as custodian for the Chargor and form part of the collateral provided by the Chargor in satisfaction of its requirements under the Procedures. Upon such designation, the Clearing House shall hold such Securities as custodian for the Chargor, subject to the terms of this Deed.
- (3) Where any Securities referred to in sub-paragraphs (1) or (2) are held by or for the account of the Clearing House in any Clearance System or with any Custodian Bank, the Clearing House will identify in its books that such Securities are held by it as custodian for the Chargor.
- (4) All Distributions received by the Clearing House on any Securities which are held by the Clearing House as custodian for the Chargor in accordance with sub-paragraphs (1) or (2) shall be deposited by the Clearing House in a Cash Account and held by the Clearing House as custodian for the Chargor.
- (5) For the avoidance of doubt, the Clearing House may hold any Securities and Distributions pursuant to this Clause 2A (*Custody of Collateral*) in one or more omnibus accounts together with other Securities and cash amounts which it holds as custodian for other third parties which have granted a charge over such Securities in favour of the Clearing House in a form substantially the same as this Deed (each a "**Relevant Charge**"). The Clearing House shall ensure that any such account with a Clearance System or Custodian Bank is clearly identified as a custody account relating to Relevant Charges.
- (6) The Clearing House undertakes to the Chargor that it will at all times ensure that, pursuant to the terms governing any account with any Clearance System or Custodian Bank in which any Securities or cash (including any Distributions) are held for the Chargor, any claim or security interest which that Clearance System or Custodian Bank may have against or over such Securities or cash (including any Distributions) shall be limited to any unpaid fees owed by the Clearing House to such Clearance System or Custodian Bank in respect of such account.

3. Charge

- (1) The Chargor acting in due capacity (as defined in sub-paragraph (3) below) (and to the intent that the security so constituted shall be a security in favour of the Clearing House extending to all beneficial interests in the assets hereby charged and to any proceeds of sale or other realisation thereof or of any part thereof including any redemption monies paid or payable in respect thereof) hereby assigns, charges and pledges by way of first fixed security and by way of continuing security to the Clearing House, until discharged by the Clearing House in accordance with this Deed, for the payment to the Clearing House and the discharge of all the Secured Obligations, the Charged Property (as defined in paragraph (3) below).
- (2) It shall be implied in respect of Clause 3(1) that the Chargor is charging the Charged Property free from all charges and encumbrances (whether monetary or not) and from all other rights exercisable by third parties (including liabilities imposed and rights conferred by or under any enactment) except for any charge or lien arising in favour of a Custodian Bank or Clearance System and for any third party's beneficial interest in the Charged Property which ranks behind the rights of the Clearing House in respect of the Charged Property.
- (3) In this Deed:

"**acting in due capacity**" in relation to the Chargor means that each of the dispositions of property hereby effected by the Chargor is made with full title guarantee subject to any other charge or lien arising in favour of a Custodian Bank or Clearance System;

"**Cash Account**" means an account with a Custodian Bank in which the Clearing House will deposit and hold all monies forming part of the Charged Property from time to time;

"**Charged Property**" means at any time all present and future right, title and interest of the Chargor in and to:

- (i) all Securities held by the Clearing House as custodian for the Chargor pursuant to Clauses 2A(1) and (2) which are for the time being held by, or by any Clearance System on behalf of, for the account of, to the order of or under the control or direction of the Clearing House; and
- (ii) all Securities held by the Clearing House as custodian for the Chargor pursuant to Clauses 2A(1) and (2) which are for the time being held by, or by any Clearance System on behalf of, for the account of or to the order of or under the control or direction of a Custodian Bank, for the account of the Clearing House.

"Clearance System" shall be construed as a reference to any system from time to time used or constituted for the clearing, collective safe custody or central deposit of securities, and any depository for any of the foregoing;

"Clearing Membership Agreement" means in relation to the Chargor the "Clearing Membership Agreement" between the Chargor and the Clearing House having the date specified on the first page of this Deed, as such agreement may be amended and or replaced from time to time;

"Custodian Bank" means a bank or custodian with which the Clearing House maintains any Cash Account or any securities account in which it holds any Securities belonging to the Chargor or any nominee company or trust company which is a subsidiary of such a bank or custodian;

"Deed" means this charge made between the Chargor and the Clearing House on the date above-stated, as the same may be amended, supplemented or restated from time to time;

"Distributions" means all rights, benefits and proceeds including, without limitation, any dividends or interest, annual payments or other distributions attaching to or arising from or in respect of any Securities forming part of the Charged Property;

"Procedures" means the one or more documents containing the working practices and administrative requirements of the Clearing House for the purposes of implementing the Clearing House's Rulebook and Default Rules from time to time in force, or procedures for application for and regulation of clearing membership of the Clearing House;

"Receiver" means a receiver or manager or an administrative receiver as the the Clearing House may specify at any time in the relevant appointment made under this Deed, which term will include any appointee made under a joint and/or several appointment by the Clearing House; and

"Securities" shall be construed as a reference to bonds, debentures, notes, stock, shares, bills, certificates of deposit and other securities and instruments and all monies, rights or property which may at any time accrue or be offered (whether by way of bonus, redemption, preference, option, substitution, compensation or otherwise) in respect of any of the foregoing (and without limitation, shall include any of the foregoing not constituted, evidenced or represented by a certificate or other document but by any entry in the books or other records of the issuer, a trustee or other fiduciary thereof, or a Clearance System).

4. Release

(1) Upon the Clearing House being satisfied (acting in good faith) that the Secured

Obligations have been irrevocably paid or discharged in full, the Clearing House shall, at the request and cost of the Chargor, release or discharge (as appropriate) all the Charged Property from the security created by this Deed provided that, without prejudice to any remedy which the Chargor may have if the Clearing House fails to comply with its obligations under this Clause, such actions shall be without recourse to, and without any representations or warranties by, the Clearing House or any of its nominees.

- (2) The Chargor may, in the circumstances specified in Sections 4.1.2 and 4.1.3 of the Procedures, request that part or all of the Charged Property, or the proceeds thereof, be returned or repaid to, or to the order of, the Chargor. Where, pursuant to such a request, any of the Charged Property, or the proceeds thereof, is actually returned or repaid pursuant to Sections 4.1.2 or 4.1.3 of the Procedures, such Charged Property shall be released or discharged (as appropriate) from the security interest created over such Charged Property and the proceeds thereof pursuant to Clause 3(1) with effect from the time such Charged Property, or the proceeds thereof, are transferred by the Clearing House to, or to the order of, the Chargor in accordance with the Procedures.

5. **Income**

Prior to the enforcement of the security created by this Deed, all Distributions received by the Clearing House in respect of any Charged Property shall be paid by the Clearing House to the Chargor.

6. **Reinstatement**

If any discharge, release or arrangement is made by the Clearing House in whole or in part on the basis of any payment, security or other disposition which is avoided or must be restored in insolvency, liquidation, administration or otherwise, without limitation, then the liability of the Chargor and the security created by this Deed will continue or be reinstated as if the discharge, release or arrangement had not occurred.

7. **Warranties and Undertakings**

The Chargor hereby represents and warrants to the Clearing House and undertakes that:

- (i) the Chargor is duly incorporated or organised and validly existing under the laws of its jurisdiction of organisation or incorporation;
- (ii) the Chargor and each of its subsidiaries has the power to own its assets and carry on its business as it is being conducted;
- (iii) subject to any legal or equitable interest which any common depository, Clearance System or Custodian Bank may have in any Securities and to any

third party's beneficial interest in the Charged Property which ranks behind the rights of the Clearing House in respect of the Charged Property, the Chargor is and will at all times during the subsistence of the security and security interest hereby constituted, be the sole and lawful owner of, and be entitled to the entire beneficial interest in, the Charged Property free from mortgages or charges (other than as a result of the security created under this Deed, any charge or lien arising in favour of any Clearance System or Custodian Bank and any charge in favour of the Chargor) or other encumbrances and no other person (save as aforesaid) has any rights or interests therein;

- (iv) save as contemplated by Clause 4(2), the Chargor has not sold or agreed to sell or otherwise disposed of or agreed to dispose of, and will not at any time during the subsistence of the security hereby constituted sell or agree to sell or otherwise dispose of or agree to dispose of, the benefit of all or any rights, titles and interest in and to the Charged Property or any part thereof;
- (v) the Chargor has and will at all material times have the necessary power to enable the Chargor to enter into and perform the obligations expressed to be assumed by the Chargor under this Deed;
- (vi) this Deed constitutes a legal, valid, binding and enforceable obligation of the Chargor and is a security over, and confers a first security interest in, the Charged Property and every part thereof effective in accordance with its terms (subject to applicable bankruptcy, reorganisation, insolvency, moratorium or similar laws affecting creditors' rights generally and subject, as to enforceability, to equitable principles of general application (regardless of whether enforcement is sought in a proceeding in equity or at law));
- (vii) all necessary authorisations to enable or entitle the Chargor to enter into this Deed have been obtained and are in full force and effect and will remain in such force and effect at all times during the subsistence of the security hereby constituted;
- (viii) the execution of this Deed does not violate any agreement to which the Chargor is a party or breach any obligation to which the Chargor is subject;
- (ix) it has been and shall at all times remain expressly agreed between the Chargor and each of the Chargor's clients or other persons who are for the time being (or would be, but for the provisions of this Deed) entitled to the entire beneficial interest in all or any parts of the Charged Property that, in relation to any assets from time to time held by the Chargor or delivered to the Chargor for the account of any such client or other person which at any time form part of the Charged Property, the Chargor may, free of any interest of any such client or other person therein which is adverse to the Clearing House, charge or otherwise constitute security over such assets with the result that the Chargor may charge or otherwise constitute security over such assets in favour of the Clearing House on such terms as the Clearing House may from time to time

prescribe and, in particular but without limitation, on terms that the Clearing House may enforce and retain such charge or other security in satisfaction of or pending discharge of all or any obligations of the Chargor to the Clearing House;

- (x) in no case is the Chargor or the Chargor's client or other person who is for the time being the lawful owner of or person entitled to the entire beneficial interest in any part of the Charged Property, nor will the Chargor, client or other such person be, in breach of any trust or other fiduciary duty in placing or authorising the placing of any Charged Property (or rights, benefits or proceeds forming part of the Charged Property) under this Deed;
- (xi) no corporate actions, legal proceedings or other procedure or steps have been taken in relation to, or notice given in respect of, a composition, compromise, assignment or arrangement with any creditor of the Chargor or in relation to the suspension of payments or moratorium of any indebtedness, winding-up, dissolution, administration or reorganisation (by way of voluntary arrangement, scheme of arrangement or otherwise) of, or the appointment of an administrator to, the Chargor (other than any which will be dismissed, discharged, stayed or restrained within 15 days of their instigation) and no such step is intended by the Chargor (save for the purposes of any solvent re-organisation or reconstruction which has previously been approved by the Clearing House);
- (xii) the Chargor undertakes to abide by the Procedures as in effect from time to time.

8. **Negative Pledge**

- (1) The Chargor hereby undertakes with the Clearing House that at no time during the subsistence of the security hereby constituted will the Chargor, otherwise than:
 - (i) in favour of the Clearing House; or
 - (ii) with the prior written consent of the Clearing House and in accordance with and subject to any conditions which the Clearing House may attach to such consent,

create, grant, extend or, except in relation to any charge or lien in favour of any Clearance System or Custodian Bank, permit to subsist any mortgage or other fixed security or any floating charge or other security interest on, over or in the Charged Property or any part thereof. The foregoing prohibition shall apply not only to mortgages, other fixed securities, floating charges and security interests which rank or purport to rank in point of security in priority to the security hereby constituted but also to any mortgages, securities, floating charges or security interests which rank or purport to rank *pari passu* therewith or thereafter.

- (2) Sub-paragraph (1) above does not, during the subsistence of the security hereby constituted, operate to prevent the Chargor from continuing to hold a security interest in the Charged Property previously created in favour of the Chargor, *provided always* that the interest in favour of the Chargor shall rank after the security created by this Deed.

9. **Preservation of Charged Property**

Until the security hereby constituted shall have been discharged:

- (a) the Chargor shall ensure, so far as the Chargor is able, that all of the Charged Property is and at all times remains free from any restriction on transfer; and
- (b) the Chargor shall pay all payments due in respect of any part of the Charged Property, and in any case of default by the Chargor in this respect the Clearing House may if it thinks fit make any such payments on behalf of the Chargor in which event any sums so paid shall be reimbursed on demand by the Chargor to the Clearing House and until reimbursed shall bear interest in accordance with Clause 2(2) above.

10. **Rights Attaching to the Charged Property**

- (1) The Chargor shall not, to the extent that the same is within the control of the Chargor, permit or agree to any variation of the rights attaching to or conferred by the Charged Property or any part thereof without the prior consent of the Clearing House in writing.
- (2) Subject to sub-paragraph (3), the Clearing House and its nominees may at the Clearing House's discretion (in the name of the Chargor or otherwise whether before or after any demand for payment hereunder and without any consent or authority on the part of the Chargor) exercise in respect of any Securities which form part of the Charged Property the powers and rights conferred on or exercisable by the bearer or holder thereof.
- (3) The Clearing House shall not have any right of use or re-hypothecation right, in respect of the Charged Property, whether under Regulation 16 of the Financial Collateral Arrangements (No.2) Regulations 2003, the New York Uniform Commercial Code or any applicable Federal law of the United States or otherwise, *provided that* this provision shall not affect the powers of the Clearing House under Clauses 13 (*Power of Sale*) and 14 (*Right of Appropriation*) or any other rights to enforce the security interest herein created against the Charged Property.

11. **Further Assurance**

- (1) In the case of any part of the Charged Property situated in the United States of America, it is acknowledged and agreed by the Chargor that this Deed shall

also constitute a security agreement for the purpose of creating a security interest in the Charged Property under applicable provisions of the Uniform Commercial Code or other applicable laws or regulations of the State of New York. For purposes hereof, "**Charged Property situated in the United States of America**" means (i) in the case of any securities account and/or securities entitlements or other rights or assets or investment property credited to a securities account as financial assets, a securities account maintained with a securities intermediary whose jurisdiction is New York or any other State of the United States for purposes of the NY UCC; (ii) in the case of any deposit account and/or any amounts credited to a deposit account, a deposit account maintained with a bank whose jurisdiction is New York or any other State of the United States for purposes of the NY UCC; and (iii) in the case of any commodity account or any commodity contract credited to a commodity account such commodity account is maintained with a commodity intermediary whose jurisdiction is New York or any other State of the United States for purposes of the NY UCC . In furtherance of the foregoing and without limiting the generality of Clause 3 above, in order to secure the payment, performance and observance of the Secured Obligations, the Chargor hereby grants to the Clearing House a continuing security interest in, right of setoff against, and an assignment to the Clearing House of all of the Charged Property situated in the United States of America and all rights thereto, in each case whether now owned or existing or hereafter acquired or arising and which shall include, without limitation, all of the Chargor's interests in any deposit accounts, investment property and securities entitlements (as such terms are defined in the Uniform Commercial Code of the State of New York; the "**NY UCC**"), together with all Proceeds (as defined in the NY UCC) and products of all or any of the property described above.

- (2) The Chargor undertakes promptly to execute and do (at the cost and expense of the Chargor) all such deeds, documents, acts and things as may be necessary or desirable in order for the Clearing House to enjoy a fully perfected security interest in the whole of the Charged Property, including without limitation the deposit of the Charged Property with a Custodian Bank and the perfection of pledges or transfers under such laws, of whatever nation or territory, as may govern the pledging or transfer of the Charged Property or part thereof or other mode of perfection of this Deed and the security interest expressed to be created hereby. Without limiting the foregoing, the Chargor agrees with and covenants to the Clearing House that with respect to all Charged Property situated in the United States of America consisting of investment property, money, instruments, securities, securities entitlements, other financial assets and commodity contracts (as defined in the NY UCC), such Charged Property shall be held, maintained or deposited, as applicable, in a securities account or commodity account (in the case of commodity contracts) (such that, in each case, the Clearing House shall become the entitlement holder thereof, as defined in the NY UCC) or a deposit account (as defined in the NY UCC), in the case of Charged Property that may be credited to a Deposit Account, in the name of the Clearing House, or, if permitted by the

Procedures, may be maintained and held in the Chargor's name at a Custodian Bank (whose jurisdiction is New York or any other State of the United States for purposes of the NY UCC) which shall have executed and delivered to the Clearing House an agreement whereby such Custodian Bank agrees that it will comply with entitlement orders of the Clearing House without further consent by the Chargor. Notwithstanding anything to the contrary herein, in respect of any Charged Property situated in the United States of America, the Clearing House shall comply with all non-waivable requirements of the NY UCC with respect to how the secured party must deal with Collateral under its control or in its possession.

12. **Enforcement of Security**

On and at any time:

- (i) if a Default Notice is served on the Chargor in accordance with Rule 3 of the Default Rules; or
- (ii) if the Chargor requests the Clearing House to exercise any of its powers under this Deed,

(each such event a "Default"), the security created by or pursuant to this Deed is immediately enforceable and the Clearing House may, without notice to the Chargor or prior authorisation from any court, in its absolute discretion:

- (a) enforce all or any part of the security created by this Deed (at the times, in the manner and on the terms it thinks fit) and take possession of and hold, sell, or otherwise dispose of all or any part of the Charged Property (at the time, in the manner and on the terms it thinks fit); and
- (b) whether or not it has appointed a Receiver, exercise all or any of the powers, authorisations and discretions conferred by the Law of Property Act 1925 (as varied or extended by this Deed) on chargees and by this Deed on any Receiver or otherwise conferred by law on chargees or Receivers.

13. **Power of Sale**

- (1) If a Default has occurred, the Clearing House shall have and be entitled without prior notice to the Chargor to exercise the power to sell or otherwise dispose of, for any consideration (whether payable immediately or by instalments) as the Clearing House shall think fit, the whole or any part of the Charged Property and may (without prejudice to any right which it may have under any other provision hereof) treat such part of the Charged Property as consists of money as if it were the proceeds of such a sale or other disposal. The Clearing House shall be entitled to apply the proceeds of such sale or other disposal in paying the costs of such sale or other disposal and (subject to the rights or claims of

any person entitled in priority to the Clearing House) in or towards the discharge of the Secured Obligations, the balance (if any) to be paid to the Chargor or other persons entitled thereto. Such power of sale or other disposal shall operate as a variation and extension of the statutory power of sale under section 101 of the Law of Property Act 1925.

- (2) The restriction contained in section 103 of the Law of Property Act 1925 on the exercise of the statutory power of sale shall not apply to any exercise by the Clearing House of its power of sale or other disposal which shall arise, as shall the statutory power under the said section 101 of appointing a receiver of the Charged Property or the income thereof, immediately upon any such default by the Chargor as is referred to in sub-paragraph (1) of this clause. In favour of a purchaser a certificate in writing by an officer or agent of the Clearing House that either or both of such powers has arisen and is exercisable shall be conclusive evidence of that fact.
- (3) Upon any such default or failure as aforesaid the Clearing House shall also have with respect to any part of the Charged Property situated in the United States of America all of the rights and remedies of a secured party under the NY UCC or any other applicable law of the State of New York and all rights provided herein or in any other applicable security, loan or other agreement, all of which rights and remedies shall to the full extent permitted by law be cumulative.

14. **Right of Appropriation**

To the extent that any of the Charged Property constitutes "financial collateral" and this Deed and the obligations of the Chargor hereunder constitute a "security financial collateral arrangement" (in each case as defined in, and for the purposes of, the Financial Collateral Arrangements (No. 2) Regulations 2003 (SI 2003 No. 3226), as amended, (the "**Regulations**") the Clearing House shall have the right (at any time following the occurrence of a Default) to appropriate all or any part of such financial collateral in or towards discharge of the Secured Obligations and may exercise such right to appropriate upon giving written notice to the Chargor. For this purpose, the parties agree that the value of such financial collateral so appropriated shall be the market price of the Charged Property determined by the Clearing House by reference to a public index or by such other process as the Clearing House may select (acting in a commercially reasonable manner), including independent valuation. The parties agree that the method of valuation provided for in this Deed shall constitute a commercially reasonable method of valuation for the purposes of the Regulations.

15. **Immediate Recourse**

The Chargor waives any right it may have of first requiring the Clearing House to proceed against or enforce any other rights or security or claim payment from any person before claiming from the Chargor under this Deed. This waiver applies irrespective of any law or any provision of this Deed to the contrary.

16. **Consolidation of Securities**

Subsection (1) of section 93 of the Law of Property Act 1925 shall not apply to this Deed.

17. **Effectiveness of Security**

- (1) This Deed shall be in addition to and shall be independent of every other security which the Clearing House may at any time hold for any of the Secured Obligations. No prior security held by the Clearing House over the whole or any part of the Charged Property shall merge into the security hereby constituted.
- (2) This Deed shall remain in full force and effect as a continuing security unless and until the Clearing House discharges it.
- (3) Nothing contained in this Deed is intended to, or shall operate so as to, prejudice or affect any bill, note, guarantee, mortgage, pledge, charge or other security of any kind whatsoever which the Clearing House may have for the Secured Obligations of any of them or any right, remedy or privilege of the Clearing House thereunder.

18. **Avoidance of Payments**

If the Clearing House considers (acting in good faith) that any payment or discharge of the Secured Obligations is capable of being avoided or reduced by virtue of any bankruptcy, insolvency, liquidation or similar laws then such payment or discharge shall not be considered to have been made for the purposes of determining whether the Secured Obligations have been irrevocably paid or discharged in full.

19. **Power of Attorney**

The Chargor hereby irrevocably appoints the Clearing House to be the Chargor's attorney and in the Chargor's name and on the Chargor's behalf and as the act and deed of the Chargor to sign, seal, execute, deliver, perfect and do all deeds, instruments, mortgages, acts and things as may be, or as the Clearing House may consider to be, requisite for carrying out any obligation imposed on the Chargor under Clause 11 above, or for enabling the Clearing House to exercise its power of sale or other disposal referred to in Clause 13 above or for carrying any such sale or other disposal made under such power into effect, or exercising any of the rights and powers referred to in Clause 10 above, including without limitation the appointment of any person as a proxy of the Chargor. The Chargor hereby undertakes to ratify and confirm all things done and documents executed by the Clearing House in the exercise of the power of attorney conferred by this clause.

20. **Receivers and Administrators**

- (1) At any time after having been requested to do so by the Chargor or after this Deed becomes enforceable in accordance with Clause 12 the Clearing House may by deed or otherwise (acting through an authorised officer of the Clearing House), without prior notice to the Chargor:
 - (a) appoint one or more persons to be a Receiver of the whole or any part of the Charged Property;
 - (b) appoint one or more Receivers of separate parts of the Charged Property respectively;
 - (c) remove (so far as it is lawfully able) any Receiver so appointed; and
 - (d) appoint another person(s) as an additional or replacement Receiver(s).
- (2) Each person appointed to be a Receiver pursuant to Clause 20(1) will be:
 - (a) entitled to act individually or together with any other person appointed or substituted as Receiver;
 - (b) for all purposes deemed to be the agent of the Chargor which shall be solely responsible for his acts, defaults and liabilities and for the payment of his remuneration and no Receiver shall at any time act as agent for the Clearing House; and
 - (c) entitled to remuneration for his services at a rate to be fixed by the Clearing House from time to time (without being limited to the maximum rate specified by the Law of Property Act 1925).
- (3) The powers of appointment of a Receiver shall be in addition to all statutory and other powers of appointment of the Clearing House under the Law of Property Act 1925 (as extended by this Deed) or otherwise and such powers shall remain exercisable from time to time by the Clearing House in respect of any part of the Charged Property.
- (4) Every Receiver shall (subject to any restrictions in the instrument appointing him but notwithstanding any winding-up or dissolution of the Chargor) have and be entitled to exercise, in relation to the Charged Property in respect of which he was appointed, and as varied and extended by the provisions of this Deed (in the name of or on behalf of the Chargor or in his own name and, in each case, at the cost of the Chargor):
 - (a) all the powers conferred by the Law of Property Act 1925 on mortgagors and on mortgagees in possession and on receivers appointed under that Act;

- (b) all the powers of an administrative receiver set out in Schedule 1 to the Insolvency Act 1986 (whether or not the Receiver is an administrative receiver);
 - (c) all the powers and rights of an absolute owner and power to do or omit to do anything which the Chargor itself could do or omit to do;
 - (d) the power to delegate (either generally or specifically) the powers, authorities and discretions conferred on it by this Deed (including the power of attorney) on such terms and conditions as it shall see fit which delegation shall not preclude either the subsequent exercise any subsequent delegation or any revocation of such power, authority or discretion by the Receiver itself; and
 - (e) the power to do all things (including bringing or defending proceedings in the name or on behalf of the Chargor) which seem to the Receiver to be incidental or conducive to:
 - (i) any of the functions, powers, authorities or discretions conferred on or vested in him;
 - (ii) the exercise of any rights, powers and remedies of the Clearing House provided by or pursuant to this Deed or by law (including realisation of all or any part of the Charged Property); or
 - (iii) bringing to his hands any assets of the Chargor forming part of, or which when got in would be, Charged Property.
- (5) The receipt of the Clearing House or any Receiver shall be a conclusive discharge to a purchaser and, in making any sale or disposal of any of the Charged Property or making any acquisition, the Clearing House or any Receiver may do so for such consideration, in such manner and on such terms as it thinks fit.
- (6) No purchaser or other person dealing with the Clearing House or any Receiver shall be bound to inquire whether the right of the Clearing House or such Receiver to exercise any of its powers has arisen or become exercisable or be concerned with any propriety or regularity on the part of the Clearing House or such Receiver in such dealings.
- (7) Any liberty or power which may be exercised or any determination which may be made under this Deed by the Clearing House or any Receiver may be exercised or made in its absolute and unfettered discretion without any obligation to give reasons.

21. **No liability**

Neither the Clearing House nor any receiver appointed pursuant to this Deed shall be liable by reason of (a) taking any action permitted by this Deed or (b) any neglect or default in connection with the Charged Property or (c) the taking possession or realisation of all or any part of the Charged Property, except in the case of gross negligence or wilful default upon its part.

22. **Remedies, Time or Indulgence**

- (1) The rights, powers and remedies provided by this Deed are cumulative and are not, nor are they to be construed as, exclusive of any right of set-off or other rights, powers and remedies provided by law.
- (2) No failure on the part of the Clearing House to exercise, or delay on its part in exercising, any of the rights, powers and remedies provided by this Deed or by law (collectively "**the Clearing House's Rights**") shall operate as a waiver thereof, nor shall any single or partial waiver of any of the Clearing House's Rights preclude any further or other exercise of that or any other of the Clearing House's Rights.
- (3) The Clearing House may in its discretion grant time or other indulgence or make any other arrangement, variation or release with any person not party hereto (irrespective of whether such person is liable with the Chargor) in respect of the Secured Obligations or in any way affecting or concerning them or any of them or in respect of any security for the Secured Obligations or any of them, without in any such case prejudicing, affecting or impairing the security hereby constituted, or any of the Clearing House's Rights or the exercise of the same, or any indebtedness or other liability of the Chargor to the Clearing House.

23. **Costs, Charges and Expenses**

All costs, charges and expenses of the Clearing House incurred in the exercise of any of the Clearing House's Rights, or in connection with the execution of or otherwise in relation to this Deed or in connection with the perfection or enforcement of all security hereby constituted shall be reimbursed to the Clearing House by the Chargor on demand on a full indemnity basis together with interest from the date of the same having been incurred to the date of payment at the rate referred to in Clause 2(2) above.

24. **Accounts**

All monies received, recovered or realised by the Clearing House under this Deed (including the proceeds of any conversion of currency) may in the discretion of the Clearing House be credited to any suspense or impersonal account and may be held in such account for so long as the Clearing House shall think fit (with interest accruing thereon at such rate, if any, as the Clearing House may deem fit) pending their

application from time to time (as the Clearing House shall be entitled to do in its discretion) in or towards the discharge of any of the Secured Obligations.

25. **Currency**

- (1) For the purpose of or pending the discharge of any of the Secured Obligations the Clearing House may convert any monies received, recovered or realised or subject to application by the Clearing House under this Deed (including the proceeds of any previous conversion under this clause) from their existing currency of denomination into such other currency of denomination as the Clearing House may think fit, and any such conversion shall be effected at such commercial spot selling rate of exchange then prevailing for such other currency against the existing currency as the Clearing House may in its discretion determine.
- (2) References herein to any currency extend to any funds of that currency and for the avoidance of doubt funds of one currency may be converted into different funds of the same currency.

26. **Notices**

- (1) Any notice or demand (including any Default Notice) requiring to be served on the Chargor by the Clearing House hereunder may be served on any of the officers of the Chargor personally, or by letter addressed to the Chargor or to any of its officers and left at its registered office or any one of its principal places of business, or by posting the same by letter addressed in any such manner as aforesaid to such registered office or any such principal place of business.
- (2) Any notice or demand (including any Default Notice) sent by post in accordance with paragraph (1) of this clause shall be deemed to have been served on the Chargor at 10 a.m. Greenwich Mean Time on the business day next following the date of posting. In proving such service by post it shall be sufficient to show that the letter containing the notice or demand (including any Default Notice) was properly addressed and posted and such proof of service shall be effective notwithstanding that the letter was in fact not delivered or was returned undelivered.

27. **Provisions Severable**

Each of the provisions contained in this Deed shall be severable and distinct from one another and if at any time any one or more of such provisions is or becomes invalid, illegal or unenforceable, the validity, legality and enforceability of each of the remaining provisions of this Deed shall not in any way be affected, prejudiced or impaired thereby.

28. **Clearing House's Discretions**

Any liberty or power which may be exercised or any determination which may be made hereunder by the Clearing House may (save where stated to the contrary) be exercised or made in the absolute and unfettered discretion of the Clearing House which shall not be under any obligation to give reasons thereof.

29. **Law and Jurisdiction**

This Deed, and any non-contractual obligations arising herefrom, shall be governed by and construed in accordance with English law, and the Chargor hereby irrevocably submits to the non-exclusive jurisdiction of the English courts; provided that with respect to issues arising as a result of the provisions of Clause 11(1) above or the use of this Deed as a security agreement as provided therein, this Deed shall be governed by and construed in accordance with applicable laws of the State of New York.

The Chargor

Executed as a DEED by

The Chargor

[CHARGOR NAME]

.....
Signature of Director

.....
Name of Director

.....
Date

.....
Signature of Director/Secretary

.....
Name of Director/Secretary

.....
Date

The Clearing House

LCH. Clearnet Limited

.....
Signature of Director

.....
Name of Director

.....
Title of Director

.....
Date

Dated 2014

and

LCH.CLEARNET LIMITED

**CHARGE BY CLEARING MEMBER
SECURING OWN OBLIGATIONS**

Appendix C
Security Deed

SECURITY DEED

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THIS SECURITY DEED is dated [*Insert Date of Execution*] and made by way of deed poll by [**CLEARING MEMBER**] in its capacity as chargor (the "**Chargor**").

WHEREAS:

- (A) In order to facilitate the clearing of certain transactions with LCH.Clearnet Limited (the "**Clearing House**"), the Chargor has entered into one or more agreements with one or more of its clients and may enter into further agreements with such clients and/or one or more agreements with further clients, in each case that govern the terms upon which the Chargor will act as Clearing Member in respect of Client Clearing Business of that client (each such agreement, together with any related collateral, security or margining agreement, a "**Clearing Agreement**").
- (B) The Chargor is executing this Security Deed in order to maximise the ability to move positions corresponding to transactions under the Clearing Agreements to Backup Clearing Members upon the occurrence of an Enforcement Event or to provide for certain receivables to be delivered from the Clearing House to the Clients directly.

It is agreed as follows:

1. **DEFINITIONS AND INTERPRETATION**

1.1 **Definitions:**

Capitalised terms used but not defined in this Security Deed including in the Recitals shall have the meaning given to them in the LCH Rules. In addition, the following expressions shall have the following meanings:

"**Associated LCH Transactions**" means, in respect of a Client, the Contracts entered into by the Chargor with the Clearing House on behalf of such Client.

"**Authorisation Date**" means the date falling 6 months after 25 October 2013, unless the Clearing House notifies the Chargor that the Authorisation Date will be a date (the "**New Authorisation Date**") other than the then current Authorisation Date, in which case the Authorisation Date will be such New Authorisation Date. For the avoidance of doubt multiple notifications may be made and the New Authorisation Date specified in the last such notification will be the Authorisation Date.

"**Charge**" means the security interest created or expressed to be created by this Security Deed.

"**Charged Assets**" means the assets subject, or expressed to be subject, to the Charge or any part of those assets.

"**Clearing Agreement**" has the meaning ascribed to such term in Recital (A) to this Security Deed.

"**Clearing Default**" means the Chargor becoming a defaulter for the purposes of Rule 4 of the LCH Default Rules.

"**Clearing House**" has the meaning ascribed to such term in Recital (A) to this Security Deed.

"Client" means each of the clients listed in Schedule 2 to this Security Deed being, in each case, a Clearing Client who is party to a Clearing Agreement. For the avoidance of doubt, an individual Clearing Client may be party to more than one Clearing Agreement with the Chargor (due to such Clearing Client (i) receiving Client Clearing Services from the Chargor in respect or more than one Service and/or (ii) being a Clearing Client in respect of whom the Chargor has opened more than one Client Account relating to a Relevant Client Clearing Business), and in each such capacity the relevant Clearing Client will constitute a separate "Client" for the purposes of this Security Deed and will be separately identified (including with details of the relevant Service and details of the LCH identifier for the relevant Client Account) in Schedule 2 to this Security Deed.

"Effective Date" means the Authorisation Date or the date of this Security Deed, whichever is later.

"Enforcement Event" means the occurrence of a Clearing Default in relation to the Chargor in accordance with the LCH Rules.

"Insolvency Act" means the Insolvency Act 1986.

"LCH Rules" means the rules, regulations, procedures or agreements (including the LCH General Regulations and the LCH Default Rules), applicable to the Chargor and/or Associated LCH Transactions, in each case as published by the Clearing House and as the same may be amended from time to time.

"Liabilities" means all present and future obligations, moneys, debts and liabilities due, owing or incurred by the Chargor to a Client under or in connection with the Transaction Documents.

"LPA" means the Law of Property Act 1925.

"Relevant Account Property" means, in respect of a Client, the Account Balance relating to such Client, as determined by the Clearing House in accordance with the LCH Rules following an Enforcement Event.

"Relevant Clearing Agreement" means, in relation to a Client, the Clearing Agreement to which such Client is a party.

"Relevant Client Clearing Return" means, in respect of a Client, the Client Clearing Entitlement relating to such Client, as determined by the Clearing House in accordance with the LCH Rules following an Enforcement Event.

"Security" means a mortgage, charge, pledge, lien or other security interest securing any obligation of any person or any other agreement or arrangement having a similar effect.

"Transaction Documents" means this Security Deed and the Relevant Clearing Agreement.

1.2 Construction:

1.2.1 Unless a contrary indication appears, any reference in this Security Deed to:

- (a) "**assets**" includes present and future properties, revenues and rights of every description;
- (b) the "**Chargor**", a "**Client**" or any "**party**" shall be construed so as to include its successors in title and permitted transferees;
- (c) an agreement, confirmation or instrument is to a reference to that agreement or instrument as amended, novated, supplemented, extended, restated (however fundamentally and whether or not more onerous) or replaced;
- (d) a "**person**" includes any individual, firm, company, corporation, government, state or agency of a state or any association, trust, joint venture, consortium or partnership (whether or not having separate legal personality);
- (e) a "**regulation**" includes any regulation, rule, official directive, request or guideline (whether or not having the force of law) of any governmental, intergovernmental or supranational body, agency, department or of any regulatory, self-regulatory or other authority or organisation;
- (f) the singular includes the plural and vice versa; and
- (g) a provision of law is a reference to that provision as amended or re-enacted.

1.2.2 Clause and Schedule headings are for ease of reference only.

2. **UNDERTAKING TO PAY**

The Chargor undertakes to pay each of its Liabilities when due in accordance with its terms.

3. **SECURITY**

With effect from the Effective Date, the Chargor, with full title guarantee and as security for the payment of all Liabilities, charges absolutely in favour of each Client all its present and future right, title and interest in and to the Relevant Client Clearing Return and the Relevant Account Property.

4. **MULTIPLE DEEDS**

This Security Deed shall be treated as if it were a separate deed in favour of each of the Clients listed in Schedule 2 to this Security Deed, as if the Chargor had executed a separate deed in favour of each such Client so that this Security Deed confers rights severally in favour of each Client.

5. RESTRICTIONS AND FURTHER ASSURANCE

5.1 Security

The Chargor agrees that it shall not create or permit to subsist any Security over any Charged Assets except for the Charge.

5.2 Distribution of Charged Property

The Chargor hereby acknowledges and agrees that, following the occurrence of a Clearing Default, the Clearing House shall act in accordance with the LCH Rules and any other laws and regulations applicable to it in determining how the Charged Assets are to be distributed and that such action by the Clearing House shall be without prejudice to any protections afforded to it pursuant to the LCH Rules and any such other laws and regulations.

5.3 Margining

The Chargor agrees that, prior to the operation of Clause 13.1, it shall provide margin in respect of any Associated LCH Transactions to the Clearing House on an Individual Segregated Account basis or an Omnibus Segregated Account basis (as may be agreed between the Chargor and the relevant Client) in accordance with the LCH Rules.

6. PAYMENTS

6.1 No Enforcement Event

Subject as otherwise provided in this Security Deed, and for so long as no Enforcement Event has occurred, the Chargor shall be entitled to receive and retain all payments or transfers made to it in respect of the relevant Client Account in accordance with the LCH Rules. For the avoidance of doubt, the Chargor shall not be entitled to deal with the Charged Assets at any time while the Charge is in effect.

6.2 Post Enforcement Event

Following the occurrence of an Enforcement Event, the Client shall be entitled to receive directly from the Clearing House all Charged Assets and payments or transfers made in respect of a Charged Asset.

7. ENFORCEMENT AND REMEDIES

7.1 Enforcement Event

The Security created on the Effective Date shall only be enforceable, and the powers conferred by Section 101 of the LPA as varied and extended by this Security Deed shall only be exercisable, following the occurrence of an Enforcement Event.

7.2 **Power of Sale**

The statutory power of sale and the other statutory powers conferred on mortgagees by Section 101 of the LPA as varied and extended by this Security Deed shall arise on the Effective Date of this Security Deed.

7.3 **Section 103 LPA**

Section 103 of the LPA shall not apply to this Security Deed.

8. **PROVISIONS RELATING TO CLIENT**

8.1 **Client's Rights**

At any time after the occurrence of an Enforcement Event, the Client shall have the rights set out in the Schedule hereto.

8.2 **Application of Proceeds**

Subject to Clause 13.1, all amounts or assets received or recovered by the Client in the exercise of its rights under this Security Deed shall be applied in the following order: (i) in or towards the payment of the Liabilities in such order as the Client thinks fit, but in any case acting in good faith and in a commercially reasonable manner, and (ii) in payment of any surplus to the Chargor.

8.3 **Power of Attorney**

The Chargor by way of security irrevocably appoints the Client as its attorney (with full power of substitution), on its behalf and in its name or otherwise, in such manner as the attorney thinks fit, but in any case acting in good faith and in a commercially reasonable manner, to exercise (following the occurrence of an Enforcement Event only) any of the rights conferred on the Client in relation to the Charged Assets or under the LPA or the Insolvency Act. The Chargor ratifies and confirms and agrees to ratify and confirm whatever any such attorney shall do in the exercise or purported exercise of the power of attorney granted by it in this Clause 8.3.

9. **NOTIFICATION OF NEW AUTHORISATION DATE**

9.1 The Chargor agrees that the Clearing House may notify the Chargor of a New Authorisation Date by publishing a notification on the Clearing House's website.

9.2 The Chargor agrees that notice of a New Authorisation Date will be deemed to have been delivered to the Chargor upon the publication of a notice of such New Authorisation Date on the Clearing House's website.

10. **AMENDMENTS TO THE SECURITY DEED**

The Chargor may from time to time amend or revoke the terms of this Security Deed without the Client's consent, provided, however, that the Chargor undertakes:

- 10.1 not to amend or revoke this Security Deed without the prior written consent of the Clearing House; and
- 10.2 to amend this Security Deed from time to time in order to reflect such changes as may be prescribed by the Clearing House to the "Security Deed" (as defined in the LCH Rules, and upon which this Security Deed is based) from time to time in accordance with the LCH Rules.

11. **ADDITIONAL CLIENTS**

The Chargor may, after the date of this Security Deed, grant a charge on the terms of this Security Deed to one or more additional clients. On each occasion when the Chargor wishes to exercise this right, it will execute a further security deed substantially in the form set out in Schedule 3 to this Security Deed (an "**Additional Security Deed**") and will deliver to the Clearing House a copy of such Additional Security Deed, including an annex which sets out the details of the relevant client(s). For the avoidance of doubt, an Additional Security Deed may be given in respect of one or more clients.

12. **SAVING PROVISIONS**

12.1 **Continuing Security**

Subject to Clause 13, the Charge is continuing security and will extend to the ultimate balance of the Liabilities, regardless of any intermediate payment or discharge in whole or in part.

12.2 **Reinstatement**

If any discharge, release or arrangement (whether in respect of the obligations of the Chargor or any security for those obligations or otherwise) is made by the Client in whole or in part on the basis of any payment, security or other disposition which is avoided or must be restored in insolvency, liquidation or otherwise, without limitation, then the liability of the Chargor and the Charge shall continue or be reinstated as if the discharge, release or arrangement had not occurred.

12.3 **Waiver of Defences**

Neither the obligations of the Chargor under this Security Deed nor the Charge will be affected by an act, omission, matter or thing which, but for this Clause 12.3, would reduce, release or prejudice any of its obligations under any Transaction Document or the Charge (without limitation and whether or not known to the Chargor or the Client) including:

- 12.3.1 any time, waiver or consent granted to, or composition with, the Chargor or other person;
- 12.3.2 the release of the Chargor or any other person under the terms of any composition or arrangement with any creditor of any affiliate;
- 12.3.3 the taking, variation, compromise, exchange, renewal or release of, or refusal or neglect to perfect, take up or enforce, any rights against, or security over

assets of, the Chargor or other person or any non-presentation or non-observance of any formality or other requirement in respect of any instrument or any failure to realise the full value of any security;

12.3.4 any amendment, novation, supplement, extension, restatement (however fundamental and whether or not more onerous) or replacement of any Transaction Document or any other document or security; or

12.3.5 any insolvency or similar proceedings.

12.4 **Immediate Recourse**

The Chargor waives any right it may have of first requiring the Client (or any trustee or agent on its behalf) to proceed against or enforce any other rights or security or claim payment from any person before claiming from the Chargor under this Security Deed. This waiver applies irrespective of any law or any provision of a Transaction Document to the contrary.

12.5 **Additional Security**

The Charge is in addition to and is not in any way prejudiced by any other guarantees or security now or subsequently held by the Client.

13. **DISCHARGE OF SECURITY**

13.1 **Final Redemption**

Immediately upon there no longer being any Liabilities remaining (or, if earlier, immediately upon it no longer being possible for an Enforcement Event to occur), the Client shall be deemed to have immediately released, reassigned or discharged (as appropriate) the Charged Assets from the Charge and therefore:

13.1.1 the Chargor may retain for its own account; and

13.1.2 the Client shall therefore promptly pay or transfer to the Chargor,

any amounts or other assets received by such party from the Clearing House in respect of the Charged Assets. For the avoidance of doubt, it is acknowledged that the Chargor's rights under this Clause 13 shall constitute an equity of redemption (and therefore a proprietary interest to the extent of such equity of redemption) in the Charged Assets and any amounts or other assets the subject of such rights shall be returned by the Client to the Chargor.

13.2 **Consolidation**

Section 93 of the LPA shall not apply to the Charge.

14. MISCELLANEOUS PROVISIONS

14.1 Payments

All payments by the Chargor under this Security Deed (including damages for its breach) shall be made to such account, with such financial institution and in such other manner as the Client may direct.

14.2 Remedies and Waivers

No failure to exercise, nor any delay in exercising, on the part of the Client any right or remedy under this Security Deed shall operate as a waiver, nor shall any single or partial exercise of any right or remedy prevent any further or other exercise or the exercise of any other right or remedy. The rights and remedies provided in this Security Deed are cumulative and not exclusive of any rights or remedies provided by law.

14.3 Partial Invalidity

If, at any time, any provision of this Security Deed is or becomes illegal, invalid or unenforceable in any respect under any law of any jurisdiction, neither the legality, validity or enforceability of the remaining provisions nor the legality, validity or enforceability of such provision under the law of any other jurisdiction will in any way be affected or impaired.

14.4 Governing Law

This Security Deed and any non-contractual obligations arising out of or in connection with it are governed by English law.

14.5 Jurisdiction

In relation to any proceedings, each party to this Security Deed irrevocably submits to the exclusive jurisdiction of the courts of England and waives any objection to proceedings in such courts on the grounds of venue or on the grounds that the proceedings have been brought in an inconvenient forum. Each such submission is made for the benefit of the other party and shall not affect the right of any party to take proceedings in any other court of competent jurisdiction nor shall the taking of proceedings in any court of competent jurisdiction preclude any party from taking proceedings in any other court of competent jurisdiction (whether concurrently or not) unless precluded by law.

14.6 [Agent for Service of Process; Chargor

The Chargor hereby irrevocably appoints [Name of Agent] of [Address in England] to receive service of process on its behalf as its authorised agent for service of process in England. If for any reason such agent ceases to be such agent for service of process, the Chargor shall forthwith appoint a new agent for service of process in England. Nothing in this Security Deed shall affect the right to serve process in any other matter permitted by law.]

This Security Deed has been delivered on the date stated at the beginning of this Security Deed.

[CHARGOR]

[INSERT APPROPRIATE SIGNATURE BLOCK]

SCHEDULE 1 RIGHTS OF CLIENT

Following the occurrence of an Enforcement Event, the Client shall have the right, either in its own name or in the name of the Chargor or otherwise and in such manner and upon such terms and conditions as the Client thinks fit, but in any case, acting in good faith and in a commercially reasonable manner, and either alone or jointly with any other person:

1. **Take possession:** to take possession of, get in and collect the Charged Assets and to require payment to it of revenues deriving therefrom;
2. **Deal with Charged Assets:** to sell, transfer, assign, exchange or otherwise dispose of or realise the Charged Assets to any person either by public offer or auction, tender or private contract and for a consideration of any kind (which may be payable or delivered in one amount or by instalments spread over a period or deferred);
3. **Borrow money:** to borrow or raise money either unsecured or on the security of the Charged Assets (either in priority to the Charge or otherwise);
4. **Rights of ownership:** to manage and use the Charged Assets and to exercise and do (or permit the Chargor or any nominee of it to exercise and do) all such rights and things as the Client would be capable of exercising or doing if it were the absolute beneficial owner of the Charged Assets;
5. **Claims:** to settle, adjust, refer to arbitration, compromise and arrange any claims, accounts, disputes, questions and demands with or by any person relating to the Charged Assets;
6. **Legal actions:** to bring, prosecute, enforce, defend and abandon actions, suits and proceedings in relation to the Charged Assets;
7. **Redemption of Security:** to redeem any Security (whether or not having priority to the Charge) over the Charged Assets and to settle the accounts of any person with an interest in the Charged Assets; and
8. **Other powers:** to do anything else it may think fit for the realisation of the Charged Assets or incidental to the exercise of any of the rights conferred on the Client under or by virtue of any Transaction Document, the LPA or the Insolvency Act.

**SCHEDULE 2
CLIENTS**

CLIENT NAME	RELEVANT SERVICE	CLIENT ACCOUNT (LCH IDENTIFIER)

**SCHEDULE 3
ADDITIONAL SECURITY DEED**

THIS SECURITY DEED is dated [*Insert Date of Execution*] and made by way of deed poll by [CLEARING MEMBER] in its capacity as chargor (the "**Chargor**").

WHEREAS:

- (A) In order to facilitate the clearing of certain transactions with LCH.Clearnet Limited (the "**Clearing House**"), the Chargor has entered into one or more agreements with one or more clients (each such agreement, a "**Clearing Agreement**").
- (B) The Chargor has previously entered by deed poll into a security deed dated [•] in favour of certain of its clearing clients (such security deed as amended from time to time, after as well as before the date of this Security Deed, the "**Original Security Deed**").
- (C) The Chargor is executing this Security Deed in order to maximise the ability of one or more additional Client(s) to move positions corresponding to transactions under the Clearing Agreements to Backup Clearing Members upon the occurrence of an Enforcement Event or to provide for certain receivables to be delivered from the Clearing House to the Clients directly.

It is agreed as follows:

1. DEFINITIONS AND INTERPRETATION

1.1 Definitions:

- (a) For the purposes of this Security Deed, the following defined terms shall have the following meanings:

"**Client**" means each of the additional client(s) listed in the Annex to this Security Deed. For the avoidance of doubt, an individual Clearing Client may be party to more than one Clearing Agreement with the Chargor (due to such Clearing Client (i) receiving Client Clearing Services from the Chargor in respect or more than one Service and/or (ii) being a Clearing Client in respect of whom the Chargor has opened more than one Client Account relating to a Relevant Client Clearing Business), and in each such capacity the relevant Clearing Client will constitute a separate "Client" for the purposes of this Security Deed (save where the relevant Clearing Client in the relevant capacity is already a client for the purposes of the Original Security Deed or a another security deed entered into prior to the date of this Security Deed on substantially the same terms as this Security Deed) and will be separately identified (including with details of the relevant Service and details of the LCH identifier for the relevant Client Account) in the Annex to this Security Deed.

"**Effective Date**" means the Authorisation Date or the date of this Security Deed, whichever is later;

- (b) Capitalised terms used but not defined in this Security Deed including in the Recitals shall have the meaning given to them in the Original Security Deed.

1.2 Construction:

- (a) Unless a contrary indication appears, any reference in this Security Deed to:
 - (i) "assets" includes present and future properties, revenues and rights of every description;
 - (ii) the "Chargor", a "Client" or any "party" shall be construed so as to include its successors in title and permitted transferees;
 - (iii) an agreement, confirmation or instrument is to a reference to that agreement or instrument as amended, novated, supplemented, extended, restated (however fundamentally and whether or not more onerous) or replaced;
 - (iv) a "person" includes any individual, firm, company, corporation, government, state or agency of a state or any association, trust, joint venture, consortium or partnership (whether or not having separate legal personality);
 - (v) a "regulation" includes any regulation, rule, official directive, request or guideline (whether or not having the force of law) of any governmental, intergovernmental or supranational body, agency, department or of any regulatory, self-regulatory or other authority or organisation;
 - (vi) the singular includes the plural and vice versa; and
 - (vii) a provision of law is a reference to that provision as amended or re-enacted.
- (b) Clause and Schedule headings are for ease of reference only.

2. OPERATIVE PROVISIONS

With effect from the Effective Date, this Security Deed is entered into on the same terms as the Original Security Deed, and each Client listed in the Annex to this Security Deed shall have the same rights and protections (subject to the same conditions and qualifications) as a "Client" under the Original Security Deed.

3. MULTIPLE DEEDS

The Chargor agrees that, where there is more than one Client listed in the Annex to this Security Deed, this Security Deed shall be treated as if it were a separate deed in favour of each such Client, as if the Chargor had executed a separate deed in favour of each such Client.

This Security Deed has been delivered on the date stated at the beginning of this Security Deed.

[CHARGOR]

[INSERT APPROPRIATE SIGNATURE BLOCK]

ANNEX
CLIENTS

CLIENT NAME	RELEVANT SERVICE	CLIENT ACCOUNT (LCH IDENTIFIER)