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LCH Limited
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Project Evolution Phase V - Belgium

You have asked us to give an opinion in respect of the laws of Belgium ("**this jurisdiction**") in response to certain specific questions raised by LCH Limited ("**LCH**") in relation to membership, insolvency, security, set–off & netting and client clearing, and the impacts thereon resulting from the United Kingdom effectively leaving the European Union further to the vote on Brexit in the referendum held on 23 June 2016, following the transition period which ended at 23:00 GMT on 31 December 2020, such that since such date the United Kingdom has ceased to be treated as a Member State of the European Union (the "**Transition End Date**").

The relevant questions are set out in full in Section 3 of this opinion letter together with the corresponding responses.

1. TERMS OF REFERENCE AND DEFINITIONS

1.1 This opinion is given in respect of Clearing Members which are:

(a) credit institutions incorporated under the Law of 25 April 2014 on the status and supervision of credit institutions and stockbroking firms;

(b) investment firms incorporated under the Law of 25 October 2016 on investment services and on the status and supervision of portfolio management and investment advice firms ("portfolio management and investment advice firms");

(c) investment firms incorporated under the Law of 25 April 2014 on the status and supervision of credit institutions and stockbroking firms ("stockbroking firms"); and

(d) persons which are companies incorporated with limited liability,

established under the laws of this jurisdiction, and all references to a "**Relevant Clearing Member**" in this opinion shall be construed accordingly.

1.2 This opinion is given in respect of each of the SwapClear Service, the RepoClear Service, the EquityClear Service, the ForexClear Service and the Listed Interest Rates Service, and relates to obligations arising under contracts ("**Contracts**") to which LCH is a party and which have been duly registered by LCH.

1.3 Unless the context otherwise requires, in this opinion:

(a) "**Agreements**" means the Clearing Membership Agreement and the Deed of Charge;

(b) "**Arrangements**" means the Client Clearing Arrangements, the Collateral Arrangements and the Default Arrangements;

(c) "**Banking Law**" means the Law of 25 April 2014 on the status and supervision of credit institutions and stockbroking firms;

(d) "**Bank Recovery and Resolution Directive**" or "**BRRD**" means Directive no. 2014/59/EU of the European Parliament and Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms (as amended);

(e) "**Bank Recovery and Resolution Directive II**" or "**BRRD II**" means Directive no. 2019/879/EU of the European Parliament and Council of 20 May 2019 amending Directive 2014/59/EU as regards the loss-absorbing and recapitalisation capacity of credit institutions and investments firms and Directive 98/26/EC[1];

(f) "**Client Clearing Arrangements**" means the contractual arrangements by which a Relevant Clearing Member is bound to the default management procedures of LCH in respect of Contracts entered into in connection with

[1] The Bank Recovery and Resolution Directive II was published in the Official Journal of the European Union on 7 June 2019 and entered into force on 27 June 2019.

Client Clearing Business, constituted by the Relevant Clearing Member's Clearing Membership Agreement and the Rulebook, including the Client Clearing Annex of the Default Rules of LCH;

(g) "**Collateral**" means Securities (as such term is defined in the Deed of Charge) lodged by the Relevant Clearing Member with LCH pursuant to the Deed of Charge in accordance with the Procedures of LCH (and in particular, section 4 (*Collateral*) of the Procedures of LCH) and the term, for the avoidance of doubt, includes the Charged Property (as defined in the Deed of Charge);

(h) "**Collateral Arrangements**" means the security arrangements which govern the provision of Collateral by a Relevant Clearing Member to LCH, constituted by the relevant executed Deed of Charge, the Rulebook (in particular those set out in Section 4 (*Collateral*) of the Procedures of LCH) and the relevant instruction(s) through LCH's Collateral Management System;

(i) "**Deed of Charge**" means a deed of charge entered into between a Relevant Clearing Member and LCH which is substantially in the form of the Deed of Charge set out in Schedule 2 and which contains no material modifications to the wording set out in Clause 2 of that annexed form (for the avoidance of doubt, a change to the numbering of the clause or other provision in which the relevant wording appears in a particular deed of charge would not (in either such case) of itself constitute a "material modification" for these purposes);

(j) "**Default Arrangements**" means the contractual arrangements by which a Relevant Clearing Member is bound to the default management procedures of LCH, constituted by the Relevant Clearing Member's Clearing Membership Agreement and the Rulebook, including the Default Rules of LCH;

(k) "**EMIR**" means Regulation (EU) no. 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (as amended);

(l) "**EMIR 2.2**" means Regulation (EU) no. 2019/2099 of the European Parliament and of the Council of 23 October 2019 amending Regulation (EU) No 648/2012 as regards the procedures and authorities involved for the authorisation of CCPs and requirements for the recognition of third-country CCPs[2];

[2] EMIR 2.2 was published in the Official Journal of the European Union on 12 December 2019 and entered into force on 1 January 2020.

(m) "**EMIR Refit Regulation**" means Regulation (EU) no. 2019/834 of the European Parliament and of the Council of 20 May 2019 amending Regulation (EU) No 648/2012 as regards the clearing obligation, the suspension of the clearing obligation, the reporting requirements, the risk-mitigation techniques for OTC derivative contracts not cleared by a central counterparty, the registration and supervision of trade repositories and the requirements for trade repositories;

(n) "**Exempting Client Clearing Rule**" means any law, regulation or statutory provision (having the force of law) of a governmental authority the effect of which is to protect the operation of the Client Clearing Annex of the Default Rules from challenge under the insolvency rules applicable to any Relevant Clearing Member;

(o) "**EU**" means the European Union;

(p) "**Financial Collateral Directive**" means Directive no. 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements (as amended);

(q) "**Financial Collateral Law**" means the Law of 15 December 2004 on financial collateral;

(r) "**Insolvency Proceedings**" means the procedures listed in paragraphs 3.2.1(a)(i) and (iii);

(s) "**Parties**" means LCH and a single Relevant Clearing Member to which this opinion applies, and "**Party**" means either of them;

(t) "**Reorganisation Measures**" means the procedures listed in paragraphs 3.2.1(a)(ii), (iv) and (v);

(u) "**Rulebook**" means the version of the General Regulations, Procedures, Default Rules, Settlement Finality Regulations and the Product Specific Contract Terms and Eligibility Criteria Manual made available on LCH's website as at the date of this opinion letter;

(v) "**Services**" means the Services listed in paragraph 1.2;

(w) "**Settlement Finality Directive**" means Directive no. 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems (as amended);

(x) "**Settlement Finality Law**" means the Law of 28 April 1999 on the settlement finality in payment and securities payment systems;

(y) "**Winding-up Directive**" means Directive no. 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the reorganisation and winding up of credit institutions (as amended);

(z) any reference to any legislation shall be construed as a reference to such legislation as the same may have been amended or re-enacted on or before the date of this Opinion Letter;

(aa) a reference to a "paragraph" is a reference to a paragraph in this opinion and a reference to a "Section" is a reference to a section in this advice; and

(bb) headings are for ease of reference only and shall not affect interpretation of this opinion.

Terms not otherwise defined in this opinion shall have the meaning ascribed to such terms in LCH's Rulebook.

1.4 For the purposes of this opinion we have only reviewed the following documents (the "**Opinion Documents**"):

(a) the Rulebook;

(b) the Clearing Membership Agreement; and

(c) the Deed of Charge.

1.5 We have reviewed the Opinion Documents in connection with the instructions to counsel provided as attachments to an email sent to Lounia Czupper on 24 July 2018 and updates to the Rulebook provided as attachments to an email sent to Annie Cruickshank on 30 October 2020 (the "**Instructions**").

1.6 We have also reviewed a copy of (i) the ESMA Board Decision of 25 September 2020 granting recognition to LCH as a Tier 2 third country CCP under Chapter 4 of title III of EMIR pursuant to the Commission implementing decision (EU) no. 2020/1308 of 21 September 2020, determining, for a limited period of time, that the regulatory framework applicable to central counterparties in the United Kingdom of Great Britain and Northern Ireland is equivalent, and (ii) the ESMA Board Decision of 25 September 2020 on the determination of LCH as a systemically important CCP for the financial stability of the EU (Tier 2 CCP).

1.7 This advice relates solely to matters of Belgian law (as in force at the date hereof) and does not consider the impact of any laws (including insolvency laws) other than Belgian law, even where, under Belgian law, any foreign law falls to be applied.

1.8 For the purpose of issuing this opinion letter, we have made no investigation or verification, and we express no opinion, express or implied, with respect to:

1.8.1 the validity and enforceability of any provisions of any Opinion Documents without prejudice to the statement of opinion in paragraph 3 (*Opinion*) below;

1.8.2 any liability to tax as a result of or in connection with the Services, or the tax treatment of any Contract, or the tax position of any party thereto;

1.8.3 any matters of fact (including any calculations or mathematic methods or formulae, any economic or financial information or figure as well as the adequacy or the relevance of any orders of priority for payments) or the reasonableness of any statements of opinion or intention expressed in relation to any Service, including any facts, events or circumstances arising as a result of the execution of any related documents by the Parties or the performance of the Parties' obligations deriving therefrom;

1.8.4 any prudential treatment of any Relevant Clearing Member's exposure to LCH (or any part thereof);

1.8.5 the compliance of the Opinion Documents with the provisions of EMIR (as amended by the EMIR Refit Regulation and by EMIR 2.2);

1.8.6 the impact of Article 55 of the BRRD (implemented in Belgium by Article 267/15 of the Banking Law) on LCH and Relevant Clearing Members post Brexit;

1.8.7 the impact on the opinions expressed in this Opinion Letter of

(a) Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments amending Directive 2002/92/EC and Directive 2011/61/EU (recast), dated 15 May 2014, as implemented into Belgian law;

(b) Regulation (EU) no. 600/2014 of the European Parliament and of the Council on markets in financial instruments and amending Regulation (EU) No. 648/2012 on OTC derivatives, central counterparties and trade repositories dated 15 May 2014;

(c) Regulation (EU) 2019/2175 of the European Parliament and Council of 18 December 2019 amending Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority), Regulation (EU) No 1094/2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), Regulation (EU) No 1095/2010 establishing a European Supervisory Authority (European Securities and Markets Authority), Regulation (EU) No 600/2014 on markets in financial instruments, Regulation (EU) 2016/1011 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds, and Regulation (EU) 2015/847 on information accompanying transfers of funds;

(d) Directive (EU) 2019/2162 of the European Parliament and of the Council of 27 November 2019 on the issue of covered bonds and covered bond public supervision and amending Directives 2009/65/EC and 2014/59/EU; and

(e) the proposal for a regulation of the European Parliament and of the Council on a framework for the recovery and resolution of central counterparties and amending Regulations (EU) No 1095/2010, (EU) No 648/2012, and (EU) 2015/2365.

1.9 This Opinion Letter is given as of 31 December (23:00 GMT) 2020.

2. ASSUMPTIONS

2.1 Assumptions relating to the application of foreign laws

We assume:

2.1.1 That from the Transition End Date onwards, the Bank Recovery and Resolution Directive and the amendments made to such directive pursuant to the Bank Recovery and Resolution Directive II, the Settlement Finality Directive and the Financial Collateral Directive, as the same are applicable in the United Kingdom immediately before the Transition End Date, are embedded into the domestic legal system of the United Kingdom with no substantive change.

2.1.2 That the Agreements and all Contracts are legal, valid, binding and enforceable in accordance with their respective terms and conditions under the law by which they are expressed to be governed and the laws of the places where the

obligations thereunder have to be or have been performed[3] (save that this assumption does not apply to the Agreements when governed by Belgian law or where the place of performance is Belgium).

2.1.3 For the purposes of the opinions expressed in paragraph 3.2.2(d) (*For completeness: the Financial Collateral Law*) below, that the Deed of Charge constitutes a financial collateral arrangement under English law.

2.2 Assumptions relating to both Parties

We assume:

2.2.1 That each Party has the capacity, power and authority, under all applicable laws, to enter into and to exercise its rights and to perform its obligations under the Agreements and all Contracts, and that each Party has duly authorised, executed and delivered the Agreements and Contracts and taken all necessary steps to ensure their legality, validity, enforceability and admissibility in evidence in Belgium.

2.2.2 That each Party holds and complies with all regulatory licences or other requirements applicable in connection with its entry into and exercise of its rights and performance of its obligations under the Agreements and all Contracts.

2.2.3 That there is no other agreement, instrument or other arrangement between or affecting the Parties to the Agreements which conflicts with, overrides, modifies or supersedes the Agreements.

2.2.4 That each Agreement and Contract is entered into prior to the commencement of any Insolvency Proceedings against either Party.

2.2.5 That (save in relation to any non-performance by one Party which leads to the taking of action by the other Party under the termination and close-out provisions of the Agreements) each Party will duly perform its obligations under each Agreement and Contract in accordance with their respective terms.

[3] This assumption is required because the courts of Belgium may give effect, at their discretion, to the overriding mandatory laws of any jurisdiction where the obligations arising out of an agreement have to be or have been performed; they may also take into account the law of the place of performance in relation to the manner of performance and to the steps to be taken in the event of defective performance. Regulation 593/2008 of 17 June 2008 on the law applicable to contractual obligations ("**Rome I**"), Art. 9.3 and 12.2

2.2.6 That the obligations assumed under the Agreements and the Contracts are "mutual" between the Parties, in the sense that the Parties are each personally and solely liable as regards obligations owing by it to the other Party and solely entitled to the benefit of obligations owed to it by the other Party.

2.3 Assumptions relating to the Collateral

We assume:

2.3.1 That each Party, when transferring Collateral pursuant to the Collateral Arrangements, has full legal title to such Collateral at the time of transfer, free and clear of any lien, claim, charge or encumbrance or any other interest of the transferring party or of any third person (other than a lien routinely imposed on all securities in a relevant clearance or settlement system).

2.3.2 That all Collateral transferred pursuant to the Collateral Arrangements is freely transferable and all acts or things required by the laws of this or any other jurisdiction to be done to ensure the validity of each transfer of Collateral pursuant to the Collateral Arrangements will have been effectively carried out.

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

2.3.4 For the purposes of the opinions expressed in paragraph 3.2.2(d) (*For completeness: the Financial Collateral Law*) below, that the collateral securities transferred pursuant to the Deed of Charge are constituted solely of financial instruments within the meaning of Article 3 1° of the Financial Collateral Law (as to which see paragraph 3.2.2(d) below).

2.3.5 For the purposes of the opinions expressed in paragraph 3.2.2(d) (*For completeness: the Financial Collateral Law*) below, that, at any time, LCH, acting as chargee under the Deed of Charge, maintains continued possession or control over the Charged Property.

2.3.6 That the provision of Collateral to LCH can be evidenced in writing or by electronic means and any other durable medium and that such evidencing permits the identification of the Collateral as such.

2.3.7 That the characteristics of the English law security interest purported to be created by the Deed of Charge are similar to a Belgian pledge (*nantissement* or *pand*), and the opinions given in this opinion letter are therefore based on our

view that the Deed of Charge should have the effect of a pledge (*nantissement* or *pand*). Note, however, that a court may disagree with this analysis.

3. OPINION

On the basis of the foregoing terms of reference and assumptions and subject to the qualifications set out in paragraph 4 below, we are of the following opinion.

3.1 Membership

3.1.1 ***Would LCH be deemed to be domiciled, resident or carrying on business in the Relevant Jurisdiction by virtue of providing clearing services to a Relevant Clearing Member? If so, would LCH be required to obtain 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?***

Article 25(1) of EMIR, which is directly applicable in Belgium, provides that "*A CCP established in a third country may only provide clearing services to clearing members or trading venues established in the Union where that CCP is recognised by ESMA*". Article 25(2b) of EMIR (as amended by EMIR 2.2) further provides that where ESMA determines a CCP to be systemically important or likely to become systemically important (Tier 2 CCP), it will only recognise that CCP to provide certain clearing services or activities where, in addition to the existing recognition conditions under Article 25 of EMIR, certain other specific requirements are met. As LCH has become a recognised Tier 2 third country CCP in accordance with Article 25 of EMIR, it may provide clearing services to clearing members in Belgium and would not be required to obtain a license or be registered in Belgium.

3.2 Insolvency, Security, Set-off and Netting

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

(a) *Insolvency Proceedings and Reorganisation Measures*

The only bankruptcy, composition, rehabilitation or other insolvency or reorganisation procedures to which a Party could be subject in this jurisdiction are the following:

(i) bankruptcy (*faillite / faillissement*) under Title VI of Book XX of the Code of Economic Law; article XX.32 of the Code of Economic Law also permits the temporary appointment of a provisional administrator (*administrateur provisoire / voorlopige bewindvoerder*) in the anticipation of a possible declaration of bankruptcy;

(ii) judicial reorganisation (*réorganisation judiciaire / gerechtelijke reorganisatie*) under Title V of Book XX of the Code of Economic Law; article XX.36 of the Code of Economic Law also permits the appointment of a company ombudsman *(médiateur d'entreprise / ondernemingsbemiddelaar)* to facilitate reorganisation of the company and article XX.30 of the Code of Economic Law permits the appointment of a judicial representative (*mandataire de justice / gerechtsmandataris*) if the continuity of the business is jeopardised; reorganisation proceedings, however, are not available to credit institutions, insurance companies and certain other categories of regulated financial institutions[4];

(iii) voluntary or judicial liquidation (*liquidation / vereffening*) under the Companies and Associations Code; it should be noted that a liquidation does not necessarily imply that the entity is insolvent

[4] Book XX of the Code of Economic Law, Art. XX.1 § 3.

properly speaking, but the proceeding triggers the applicability of many rules of insolvency law;

(iv) recovery measures (*mesures de redressement / herstelmaatregelen*) or exceptional measures (*mesures exceptionnelles / uitzonderingsmaatregelen*) taken by the supervisory authority, or resolution measures (*mesures de résolution / afwikkelingsmaatregele*n) taken by the resolution authority in respect of a credit institution or a stockbroking firm under the law of 25 April 2014[5]; and

(v) exceptional measures (*mesures exceptionnelles / uitzonderingsmaatregelen*) taken by the Financial Services Markets Authority in respect of a portfolio management and investment advice firm under the law of 25 October 2016.

Immunities against Insolvency Proceedings and Reorganisation Measures are generally available to public authorities. These immunities will not affect the effectiveness of the Arrangements in accordance with the analysis made in this opinion, however, because the core of this analysis is based on the Settlement Finality Law and the Financial Collateral Law which apply equally to public authorities[6].

The events and procedures specified in Rules 3 and 5 of the Default Rules adequately refer to all Insolvency Proceedings and Reorganisation Measures except:

(A) the commencement of judicial reorganisation proceedings or the appointment of a company ombudsman (*médiateur d'entreprise / ondernemingsbemiddelaar*) as referred to in paragraph 3.2.1(a)(ii) above;

(B) the recovery measures or exceptional measures and resolution measures referred to in paragraph 3.2.1(a)(iv) above; and

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5 Law of 25 April 2014, Book II, Titles VI and VIII, and Book XII, Title II, Chapters VI and VII.

6 Settlement Finality Law, Art. 1/1, 2° and 6°. With regard to the broad *ratione personae* scope of the Financial Collateral Law, see R. Houben, *Schuldvergelijking*, No. 917 *et seq.* and the references. The Financial Collateral Directive (Art. 1.2(a)) made it mandatory to include public authorities within the scope of the Law on Financial Collateral in any event.

(C) the exceptional measures referred to in paragraph 3.2.1(a)(v) above.

(b) *Special considerations regarding credit institutions and stockbroking firms*

(i) Summary of the BRRD (as implemented in Belgium by the Banking Law)

The BRRD introduces into EU law a common set of powers enabling resolution authorities to resolve banks that are failing or likely to fail without the need to place the bank into ordinary insolvency proceedings. It entrusts the resolution authority with a set of tools and powers to intervene swiftly and at a sufficiently early stage in a non-viable entity, in order to ensure the continuity of the entity's critical functions, while minimising the impact of its potential failure on the economy and the financial system.

The BRRD envisages that resolution authorities will have the power to apply certain resolution tools to banks and their holding companies when the bank is failing or likely to fail and there is no reasonable prospect of alternative private sector measures (including write down of capital instruments under the pre-resolution powers mentioned below) averting failure, and resolution action is in the public interest. In applying the tools, the resolution authorities are also instructed to observe certain resolution principles, including that the shareholders of the institution under resolution bear first losses.

In Belgium, the Bank Recovery and Resolution Directive was implemented by the Banking Law. The Bank Recovery and Resolution Directive II entered into force on 27 June 2019[7]. The BRRD II amends certain provisions of the BRRD (the BRRD II therefore does not supersede the BRRD nor replace the BRRD in its entirety).

Under Article 3(1) of BRRD II, Member States were required to bring into force the laws, regulations and administrative

[7] Article 3(1) of BRRD II.

provisions necessary to comply with BRRD II by no later than 28 December 2020. However, BRRD II has not yet been implemented in Belgium.

Under the Banking Law, the resolution authority has the following discretionary tools (in line with Article 37(3) of the BRRD):

(A) **Sale of business tool**: the power to transfer the shares of the institution in resolution or all or part of its business to a purchaser.

(B) **Bridge institution tool**: the power to transfer the shares of the institution in resolution or all or part of its business to a bridge entity owned or controlled by public authorities.

(C) **Asset separation tool**: the power to transfer assets, rights or liabilities of an institution in resolution to one or more asset management vehicles. This tool can only be used in combination with one of the other tools.

(D) **Bail-in tool**: the power to deal with the liabilities of an institution in resolution by either writing them down or converting all or part of them into shares in the institution or its parent, in any combination.

(ii) Bail-in

Under Articles 276 § 2 4°/1 and 276 § 2 4°/2 of the Banking Law (which implement Articles 63(1)(e) and 63(1)(f) of the BRRD), the resolution authorities can cancel a liability owed by a bank or modify it. The effect of this power is to "bail-in" the liabilities of a failing bank, by forcing its creditors to accept less in payment than they would otherwise be entitled to.

The scope of liabilities which may be the subject of the bail in power are broad and liabilities arising under derivative contracts are "eligible liabilities" (or "bail-inable liabilities" pursuant to the BRRD as amended by BRRD II) potentially subject to a bail-in with the write down or conversion happening on close out.

As regards derivative exposures, bail-in must follow close-out – that is, obligations arising under derivative instruments may not be bailed in until the relevant derivatives have been closed out (Article 49 of the BRRD and Article 267/9 of the Banking Law). In the context of derivatives cleared through a CCP, the expectation is that this calculation would be done by applying the default mechanism of the relevant CCP. This is provided for in Recital 17 of the EU Commission Delegated Regulation 2016/1401 on the valuation of derivatives in resolution (the "**Regulation**"), which provides that "*In the event that a CCP clearing member is placed under resolution, and the resolution authority closed-out derivative contracts prior to a bail-in, that clearing member would qualify as a defaulting clearing member with regard to the CCP in relation to the particular netting set(s).*"

The Regulation goes on to say that where the relevant CCP is authorised or recognised under EMIR, the default mechanism of that CCP should be treated by EU resolution authorities as reliable.

It is notable that the sequence of events envisaged in the Regulation assumes that the member will be placed in default at or after the moment of commencement of resolution. This raises an issue as regards Art 68 BRRD (implemented in Belgium by Article 287 of the Banking Law), which prohibits a counterparty (including a CCP) from bringing enforcement action under a contract by reason only of the commencement of resolution. Technically, therefore, where a member is placed in resolution but continues to perform all of its obligations, LCH cannot commence default proceedings. However, the resolution administrator may at any time cause default proceedings to be commenced, either by intentionally defaulting on obligations to the clearing house or through the exercise of the resolution power to close out derivatives or financial contracts under Article 63(1)(k) of the BRRD (implemented in Belgium by Article 276 § 2 4°/5 of the Banking Law). It does appear, however, that until such default proceedings have been completed, no exposure of the entity can be bailed in. This is because bail-in is required to be effected *pari passu* across all

creditors of similar seniority, derivatives creditors rank *pari passu* with other senior creditors, and derivatives creditors can only be bailed in once the relevant positions have been closed out (Article 73 of the BRRD and Article 282 of the Banking Law). Even where the result of the application of these netting provisions is to leave an amount due from the customer to the CCP, the extent to which such a claim can be written down as part of a bail-in is subject to a number of fixed "ex ante exclusions" under Article 44(2) of the BRRD (Article 267/1 of the Banking Law and the definition of "eligible debts" in Article 242 10° of the Banking Law) and the "exceptional circumstances exclusions" under Article 44(3) of the BRRD (Article 267/2 of the Banking Law) which limit the application of the bail-in tool. Essentially the exclusions apply either because the liabilities would not ordinarily be exposed to losses in insolvency or because exposing them to losses would be likely to destabilise the bank or the wider financial system.

As far as cleared products are concerned, the relevant exemptions are as follows: (A) secured liabilities (Article 44(2)(b) of the BRRD, and Article 242 10° b) of the Banking Law) and (B) liabilities with remaining maturity of less than 7 days arising from participation in designated settlement systems and owed to the system or its participants (Article 44(2)(f) of the BRRD, and Article 242 10° f) of the Banking Law). We note that BRRD II has amended Article 44(2)(f) of the BRRD to also refer to liabilities with a remaining maturity of less than 7 days owed to third-country CCPs recognised by ESMA pursuant to Article 25 of EMIR.

(A) Secured liabilities

Article 267/1, read in conjunction with Article 242 10° b) of the Banking Law (which implements Article 44(2)(b) of the BRRD) excludes secured liabilities (*engagements garantis / door zekerheid gedekte verplichtingen*) including covered bonds.

The Banking Law does not contain a definition of "secured liabilities", and its implementing royal decrees

do not define this notion either. The preparatory works of the Banking Law are silent on this notion.

Given that the above provisions implement the Bank Recovery and Resolution Directive and following the principle that national law implementing an EU directive should be construed in accordance with the text and finality of such directive, we believe that the reference to "secured liabilities" in the abovementioned provisions of the Banking Law should be read as references to "secured liabilities" as defined in the Bank Recovery and Resolution Directive.

Secured liabilities are defined in Article 2(1)(67) of the BRRD as:

"*liabilities secured by a charge, pledge or lien, or collateral arrangements, including liabilities arising from repurchase transactions and other title transfer collateral arrangements*".

Thus, before a Relevant Clearing Member's default, in accordance with Article 267/1, read in conjunction with Article 242 10° b) of the Banking Law (which implements Article 44(2)(b) of the BRRD), gross exposures under any transaction cannot be bailed in to the extent that they are "secured liabilities" (furthermore, as set out above, obligations arising under derivative instruments may not be bailed in until the relevant derivatives have been closed out). It is clear that bilateral contracts between members and a CCP are secured liabilities for this purpose. They are therefore protected by the above provisions as well as by Article 49 of the BRRD and Article 267/9 of the Banking Law (with respect to derivative instruments). However, once exposures have been netted out in the default process, it is necessarily true that if the outcome is an amount owed by the member to the CCP, that exposure will be uncollateralised, since all the available margin will have been used up before arriving at that negative number.

Thus, a net balance owed by a member to the CCP after default will not be regarded as collateralised.

(B) Liabilities with a remaining maturity of less than 7 days

Article 267/1 of the Banking Law, read in conjunction with Article 242 10° f) of the Banking Law (which implements Article 44(2)(f) of the BRRD) excludes from bail-in:

> "*liabilities with a remaining maturity of less than seven days, owed to systems or operators of systems designated according to Directive 98/26/EC [the Settlement Finality Directive] or their participants and resulting from the participation in such a system*"

It is clear from the wording of Article 242 10° f) of the Banking Law and Article 44(2)(f) of the BRRD that the carve-out does not turn on the term of the relevant contract, but on its remaining maturity.

We think that Article 242 10° f) of the Banking Law and Article 44(2)(f) of the BRRD cover cleared products since they are capable of being closed out in less than one day and that the remaining maturity test is a theoretical one that is applied on the date of commencement of resolution.

However, this exemption only applies to exposures to CCPs which are "designated" according to the Settlement Finality Directive. Thus, the question arises whether post Brexit, LCH will benefit from this exemption.

By way of background, the Settlement Finality Directive regulates "systems", defined as a formal arrangement between three or more participants, governed by the law of a Member State chosen by the participants, and "designated" as a system and notified to the European Securities and Markets Authority by the Member State

whose law is applicable, after that Member State is satisfied as to the adequacy of the rules of the system[8].

Recital (7) of the Settlement Finality Directive further provides that "*Member States may apply the provisions of this Directive to their domestic institutions which participate directly in third country systems and to collateral security provided in connection with participation in such systems*".

As explained in paragraph 3.2.3 below, in Belgium, the Settlement Finality Law purports to extend the protections of the Settlement Finality Directive to third country systems, as contemplated by Recital (7) of the Settlement Finality Directive.

Although there appears to be a gap in the Settlement Finality Law, as it does not contain any definition of "third country system", we believe that post Brexit LCH should qualify as a third country system for the purposes of the Settlement Finality Law if it satisfies the criteria for an EU system, *mutatis mutandis* (see paragraph 3.2.3 below).

There is no regulatory guidance or case law on whether a third country system, in respect of which the relevant Member State applies the protections of the Settlement Finality Directive in accordance with its Recital (7), would benefit from the exemption for liabilities with a remaining maturity of less than 7 days under Article 44(2)(f) of the BRRD (implemented by Article 267/1, read in conjunction with Article 242 10° f) of the Banking Law).

While there are certain arguments in support of the view that a third country CCP, in respect of which the relevant Member State applies the protections of the Settlement Finality Directive in accordance with its Recital (7),

[8] Article 2 of the Settlement Finality Directive.

should benefit from the above exemption [9], these arguments are uncertain – and inconsistent with the text of Article 44(2)(f) of the BRRD (implemented by Article 267/1, read in conjunction with Article 242 10° f) of the Banking Law), which refers only to systems "designated" in accordance with the Settlement Finality Directive. Given that the Settlement Finality Directive does not cater for the "designation" of third country systems – but only indicates that each Member State may treat third country systems in the same way as EU designated systems – there may be doubts as to whether a third country system (even if it is a recognised third country CCP) would benefit from the above exemption.

There is, however, a further argument in support of the view that a recognised third country CCP would benefit from the exemption for liabilities with a remaining maturity of less than 7 days. The BRRD II is now in force, although the amendments to the BRRD which arise pursuant to the BRRD II have not yet been implemented in Belgium. The BRRD II amends the BRRD to provide for an expanded exemption relating to liabilities with a remaining maturity of less than 7 days to recognised third country CCPs, by replacing Article 44(2), point (f) of the BRRD with the following: "*(f) liabilities with a remaining maturity of less than seven days, owed to systems or operators of systems designated in accordance with Directive 98/26/EC [the Settlement Finality Directive] or to their participants and arising from the participation in such a system, or CCPs authorised in the Union pursuant to Article 14 of Regulation (EU) No 648/2012 [the European Markets Infrastructure Regulation] and third-country CCPs*

[9] Recital (78) of the BRRD states that "*Where there are exemptions of liabilities such as for payment and settlement systems, employee or trade creditors, or preferential ranking such as for deposits of natural persons and micro, small and medium-sized enterprises, they should apply in third countries as well as in the Union*". In line with Recital (78), the first part of Article 44(2) states that "*Resolution authorities shall not exercise the write down or conversion powers in relation the following liabilities whether they are governed by the law of a Member State or of a third country*".

recognised by ESMA pursuant to Article 25 of that Regulation".

According to settled case law of the Court of Justice of the European Union, where a dispute falls within the scope of an EU directive, national courts are to construe the domestic legislation, so far as possible, in the light of the wording and purpose of the relevant directive in order to achieve the result sought by such directive[10]. On this basis, one could argue that the exemption for liabilities with a remaining maturity of less than 7 days is to be construed in such a way that it extends to recognised third-country CCPs (in line with Clause 44(2)(f) of the BRRD, as amended by the BRRD II), and accordingly that LCH will benefit from this exemption as LCH has become a recognised third country CCP under Article 25 of EMIR.

In addition, the BRRD, as implemented by the Banking Law, has the effect of protecting any netting arrangement that would be effective in insolvency. As regards partial transfers, these protections are provided by Article 77 of the BRRD (implemented by Article 286 §1 3° of the Banking Law). As regards bail-in, the equivalent protection is provided by Article

[10] See e.g. Judgment of 19 April 2016, DI, C 441/14, EU:C:2016:278, paragraphs 30 to 32:

"*30 While it is true that, in relation to disputes between individuals, the Court has consistently held that a directive cannot of itself impose obligations on an individual and cannot therefore be relied upon as such against an individual (see, inter alia, judgments in Marshall, 152/84, EU:C:1986:84, paragraph 48; Faccini Dori, C 91/92, EU:C:1994:292, paragraph 20; and Pfeiffer and Others, C 397/01 to C 403/01, EU:C:2004:584, paragraph 108), the fact nonetheless remains that the Court has also consistently held that the Member States' obligation arising from a directive to achieve the result envisaged by that directive and their duty to take all appropriate measures, whether general or particular, to ensure the fulfilment of that obligation are binding on all the authorities of the Member States, including, for matters within their jurisdiction, the courts (see, to that effect, inter alia, judgments in von Colson and Kamann, 14/83, EU:C:1984:153, paragraph 26, and Kücükdeveci, C 555/07, EU:C:2010:21, paragraph 47).*

31 It follows that, in applying national law, national courts called upon to interpret that law are required to consider the whole body of rules of law and to apply methods of interpretation that are recognised by those rules in order to interpret it, so far as possible, in the light of the wording and the purpose of the directive concerned in order to achieve the result sought by the directive and consequently comply with the third paragraph of Article 288 TFEU (see, inter alia, judgments in Pfeiffer and Others, C 397/01 to C 403/01, EU:C:2004:584, paragraphs 113 and 114, and Kücükdeveci, C 555/07, EU:C:2010:21, paragraph 48).

32 It is true that the Court has stated that this principle of interpreting national law in conformity with EU law has certain limits. Thus, the obligation for a national court to refer to EU law when interpreting and applying the relevant rules of domestic law is limited by general principles of law and cannot serve as the basis for an interpretation of national law contra legem (see judgments in Impact, C 268/06, EU:C:2008:223, paragraph 100; Dominguez, C 282/10, EU:C:2012:33, paragraph 25; and Association de médiation sociale, C 176/12, EU:C:2014:2, paragraph 39)."

34(1)(i) in conjunction with Article 43(2) of the BRDD (implemented by Article 245 § 1 10° of the Banking Law). Consequently, where obligations which may be bailed in are subject to a netting arrangement, netting takes place before the bail in operates with the result that only the net sum is capable of being bailed in. Both of these provisions apply to netting generally.

There are no specific protections for liabilities connected with clearing, payment or settlement systems other than the "participation in designated systems" exemption referred to above in respect of liabilities with remaining maturity of less than 7 days.

In exceptional circumstances, a resolution authority may exclude liabilities arising under derivative contracts from a bail-in where the bail-in would cause such a value destruction that the losses borne by other creditors would be higher than if those liabilities were excluded from bail-in, and where it is not possible to conduct a bail-in within a reasonable time (Article 251 of the Banking Law).

(iii) Resolution powers – stays and partial property transfer

If bail-in and other recovery planning do not rescue the failing bank, it may have to be put into resolution during which time there are several restrictions that apply to stave off the actions of third parties. These include:

(A) Disapplication of default event provisions in consequence of the exercise of a crisis prevention or crisis management measure in relation to the bank such that neither will constitute a trigger for contractual termination, netting or set-off rights or enforcement of security in relation to the institution in resolution or a member of its group on a cross default basis.

(B) Short term moratoria which suspend the bank's payment and delivery obligations, and the enforcement of security interests and the exercise of termination rights against the bank.

The moratorium rules exist to facilitate the dismantling of the failed bank and the partial transfer of its business to a successor entity (in respect of the latter the risk for LCH is that parts which ought to be transferred together become detached for example, collateral is detached from its secured obligations).

In addition, BRRD II has introduced new moratorium provisions, whereby the resolution authority may exercise the power to suspend the bank's payment and delivery obligations before the bank is put under resolution, from the moment when the determination is made that the bank is failing or likely to fail, with a view to avoiding the further deterioration of the financial condition of the bank.

During the period of a moratorium, the resolution authorities may suspend any obligation of the entity in resolution. Thus, if a Relevant Clearing Member were called for margin during such a period, it would be open to the resolution authority to suspend any such obligation for the duration of the moratorium period. It is arguable that LCH would be able to default the member in any event in such circumstances (on the basis that it would still be in breach of the LCH rules), but the safer view is that LCH would only be able to default the member on the expiry of the moratorium. This means that LCH would only be able to place the member in default on the expiry of the 2-day moratorium period.

There are a number of potentially relevant exceptions to the moratorium. Article 280 § 2 of the Banking Law (implementing Article 69(4) of the BRRD) provides that the BRRD moratorium will not apply to exposures to "central counterparties".[11] Article 288 § 2 of the Banking Law (implementing Article 70(2) of the BRRD) prohibits the resolution authority from exercising its power to prevent secured creditors enforcing their security interest in respect of security interests granted to "central

[11] Article 33a(2) of the BRRD, as inserted by BRRD II, provides that any moratorium ordered by the resolution authority prior to the commencement of resolution will not apply to exposures to "*CCPs authorised in the Union pursuant to Article 14 of Regulation (EU) No 648/2012 and third-country CCPs recognised by ESMA pursuant to Article 25 of that Regulation*". However, as noted above, the BRRD II has not yet been implemented into Belgian law.

counterparties", and Article 288 § 2 of the Banking Law (implementing Article 71(3) of the BRRD) provides that the power to suspend termination rights does not apply to the termination rights of a "central counterparty".

The Banking Law does not contain a definition of "central counterparty", and its implementing royal decrees do not define this notion either. The preparatory works of the Banking Law are silent on this notion.

Given that these provisions implement the Bank Recovery and Resolution Directive and following the principle that national law implementing an EU directive should be construed in accordance with the text and finality of such directive, we believe that the reference to "central counterparties" in the abovementioned provisions of the Banking Law should be read as references to "central counterparties" as defined in the Bank Recovery and Resolution Directive.

The definition of the term "central counterparty" can be found in Article 2(1)(64) of the BRRD – however, this simply references the definition in Art 2(1) of EMIR. This reads "*a legal person that interposes itself between the counterparties to the contracts traded on one or more financial markets, becoming the buyer to every seller and the seller to every buyer*". This is a description of clearing houses generally, and is not confined to EU CCPs. Thus in our view the benefit of the protections set out in Articles 69-71 of the BRRD (implemented by Articles 280 § 2 and 288 § 2 of the Banking Law) for clearing houses should apply to LCH from the Transition End Date onwards, as it has become a recognised third country CCP in accordance with Article 25 of EMIR. However, in the absence of any case law or regulatory guidance, we are not able to confirm that this interpretation would be upheld by a court or followed by a resolution authority.

As noted above, the BRRD II is now in force; however, the amendments to the BRRD which arise pursuant to the BRRD II have not yet been implemented in Belgium. For completeness, the text of the BRRD II states that the relevant exceptions to the

moratorium apply to third country CCPs recognised under Article 25 of EMIR.

A partial property transfer can in some circumstances have a negative impact on a creditor of a firm in resolution. In particular, where an obligation to a firm is separated from collateral given by that firm, the right to exercise or set off could in theory be lost. However, Articles 76, 77 and 78 of the BRRD (implemented by Articles 285 and 286 of the Banking Law) provide that the partial property transfer power cannot be used in circumstances where it would interfere with security arrangements, title transfer collateral arrangements, set-off or netting arrangements. Consequently, a property transfer power under BRRD could not be used on a Relevant Clearing Member in resolution in such a fashion as to disturb the existing positions of that Relevant Clearing Member with LCH, or in a way which would negatively affect LCH's ability to retain collateral and apply it in respect the existing positions of that Relevant Clearing Member. This is confirmed by Commission Delegated Regulation 2017/867, which makes clear than any arrangement between an institution and a central counterparty which is covered by a default fund should be regarded as a protected "netting agreement" under Article 76(2)(d) of the BRRD, and which provides in its recitals that "*Resolution authorities should therefore be obliged to protect all types of arrangements referred to in Article 76(2) of BRRD which are linked to counterparty's activity as a CCP*" (Recital 6). This appears to cover all forms of products which are subject to clearing, and not only derivatives.

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

(a) *The Settlement Finality Law*

Belgium has implemented the Settlement Finality Directive, which aims notably to "*minimise the disruption to a settlement system caused by insolvency proceedings against a participant in that system*"[12]. This Directive applies to systems in the European Union and to collateral security constituted by their participants in connection with their participation in these systems. Furthermore, Recital (7) of the Directive provides that "*Member States may apply the provisions of this Directive to their domestic institutions which participate directly in third country systems and to collateral security provided in connection with participation in such systems*".

In Belgium, the Settlement Finality Law (which implements the Settlement Finality Directive) extends the protections of the Settlement Finality Directive to third country systems, as permitted by Recital (7) of the Directive.[13] The aim is mainly to ensure that third country systems (and not only EU systems) are protected against the effects of insolvency proceedings against a Belgian participant. However, on the basis of the terms of the Settlement Finality Law and the preparatory works of the law, it is not clear whether this protection regime is intended to operate (i) by combining the substantive rules of the Settlement Finality Law with the rules applicable under the law governing the third country system, or (ii) solely by referring to the law governing the third country system.

On the one hand, the provisions of the Settlement Finality Law with respect to netting and transfer orders, the absence of retroactive effect of

[12] Settlement Finality Directive, Recital (4).

[13] *Doc. Parl.* Chambre, 1998/1999, nº 1999/1, p. 7, and Settlement Finality Law, Articles 2 §4 and 7 §2.

the opening of insolvency proceedings, and the provision of collateral (together the "**Settlement Finality Protective Regime**") refer to participants in a "system", and this term comprises foreign systems (as opposed to Belgian systems only). On the other hand, article 7 § 2 of the Settlement Finality Law provides that the rights and obligations arising from, or in connection with, the participation of a Belgian participant in a EU or third country payment and securities settlement system shall exclusively be governed by the foreign law governing the system (the "**Settlement System Governing Law Rule**").

On the basis of the above, the law can be read in two ways:

(i) either the third country system may rely on the "protective" effects of the Settlement Finality Law, in the sense that the provisions of the Settlement Finality Law with respect to netting and transfer orders, the absence of retroactive effect of the opening of insolvency proceedings, and the provision of collateral, will be enforceable as against third parties in general an insolvency liquidator of the Relevant Clearing Member in particular – which will prevent him or her, to such extent, from challenging transactions effected in the settlement system[14] – and the Settlement System Governing Law Rule is therefore only relevant in respect of matters not covered by the Settlement Finality Law (such as, for instance, a transfer of contracts or positions organised by the foreign settlement system in accordance with local law in the event of insolvency proceedings against a clearing member); or

(ii) the scope of the Settlement System Governing Law Rule also extends to matters covered by the Settlement Finality Law, so that questions relating to the enforceability of netting and transfer orders, the effects of the opening of insolvency proceedings, the impact of insolvency preference rules, and the

[14] *Doc. Parl.* Chambre, 1998/1999, nº 1999/1, p. 7-8; Settlement Finality Law, art. 2 §4, and the references to "system" (and not only to Belgian systems) in the relevant provisions of the Settlement Finality Law (art. 3, 6 and 8 §1).

provision of collateral, are governed by the foreign law governing the system[15].

It should also be noted that, irrespective of whether the Settlement Finality Law is read in accordance with option (i) or (ii) above, there appears to be a gap in the Settlement Finality Law, as it does not contain any definition of "third country system", but defines the concept of "system" by reference to EU systems, through the use of the same definition as the one set out in the Settlement Finality Directive (*i.e.* a system between three or more participants governed by the law of a Member State chosen by the participants and designated as a system and notified to the European Securities and Markets Authority by the Member State whose law is applicable).

Notwithstanding the above gap in the Settlement Finality Law, we believe that post Brexit LCH should qualify as a third country system for the purposes of the Settlement Finality Law if it satisfies the criteria for an EU system, *mutatis mutandis* (see paragraph 3.2.3 below).

(b) *The law applicable to the in rem effects of the security interests created by the Deed of Charge*

We understand that pursuant to the Deed of Charge, the Relevant Clearing Member agrees to grant in favour of LCH a first fixed security over certain specified Charged Property. The Deed of Charge is expressed to be governed by English law. The Charged Property is rendered subject to the charge by submission of the appropriate details, as provided at section 4 of the LCH Procedures, by the Relevant Clearing Member to LCH, and by the delivery of securities matching the description to a designated securities account maintained in the name of LCH. Charged Property is released from the charge when the chargor submits a release instruction to LCH (as provided at section 4 of the LCH Procedures) to LCH and LCH discharges the charge under clause 4(1) of the Deed of Charge by redelivering the securities specified in the release instruction to the relevant Clearing Member.

In line with the approach adopted by the Settlement Finality Directive, the Financial Collateral Directive and the Winding-up Directive,

[15] *Doc. Parl.* Chambre, 1998/1999, nº 1999/1, p. 16-17; Settlement Finality Law, art. 7 §2.

Belgian conflicts of laws rules refer to the place of the relevant intermediary to determine the law applicable to the *in rem* effects of a security interest over account-held securities, the requirements for perfection, the rules applicable to conflicts arising with concurrent rights, and the enforcement of such security interest.[16]

In other words, the connecting factor is the location of the account, opened in the books of the relevant intermediary, in which the entitlement of the beneficiary of the security interest is recorded (the "**Relevant Account Rule**"). The account is deemed to be located at the place of the principal establishment of the relevant intermediary (unless proven otherwise).

Belgian courts will apply the Relevant Account Rule rule to determine the law applicable to the requirements for perfection, the priority and the enforcement of a security interest over securities credited to an account held by LCH for the account of the Relevant Clearing Member and over which a security interest is granted in favour of LCH as collateral for the obligations of the Relevant Clearing Member to LCH under the Client Clearing Arrangements.

Therefore, on the assumption that the principal establishment of LCH is located in England (and more generally that the relevant accounts are not located outside England), English law will govern the requirements for perfection, the priority and the enforcement of the security interest in the relevant Securities granted by a Relevant Clearing Member to LCH pursuant to the Deed of Charge.

Without prejudice to the definition of "Collateral" in paragraph 1.3(g) above, we note the following for completeness in the event Collateral includes cash as well as Securities: under Belgian conflicts of laws rules, the conditions for enforcement against cash Collateral would be a matter

[16] Settlement Finality Law, article 8 §§ 2 and 3, in respect of account-held securities provided as collateral to the participants of a settlement system, to the operator of the system, to the European Central Bank or to the central bank of a Member State of the European Union; Financial Collateral Law, article 17, in respect of financial collateral arrangements; Banking Law, article 369 4°, in respect of the enforcement of proprietary rights in account-held securities in the event of insolvency proceedings (or BRRD measures) against credit institutions and stockbroking firms; Code of Private International Law, article 91, in respect of *in rem* rights over securities registered in an account or register.

of the law of the habitual residence of the Relevant Clearing Member at the time of the creation of the security interest in respect of such Collateral[17], subject to some arguments in legal doctrine referring to the law of the place where the cash Collateral is located[18].

To the extent Belgian law is applicable (because the habitual residence of the Relevant Clearing Member is in Belgium), upon the security interest created by the Deed of Charge becoming enforceable in accordance with Clause 11 of the Deed of Charge, LCH would be entitled to enforce such security interest, in respect of any cash Collateral, by appropriation of such cash Collateral to the extent of the secured obligations owed to LCH (article 9 of the Financial Collateral Law). The Financial Collateral Law further provides that LCH will apply the proceeds of the cash Collateral first against interest and secondly against principal[19], and that LCH must return any excess proceeds of enforcement to the Relevant Clearing Member.

(c) *The effects of the opening of Insolvency Proceedings or the taking of Reorganisation Measures*

As noted above, the interaction between the Settlement Finality Protective Regime on the one hand, and the Settlement System Governing Law Rule on the other hand, is not clear.

If the Settlement System Governing Law Rule applies, then the question whether, in the event of any Insolvency Proceedings being opened or Reorganisation Measures being taken against a Relevant Clearing Member, the Deed of Charge would be effective, and whether LCH would be entitled to enforce the security interests created pursuant to the Deed of Charge, or would be required to take any particular steps or abide by any particular procedures for the purposes of enforcing against

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[17] Art. 87 §3 of the Code of international private law. Article 4 §2 and 3 of the Code of international private law defines the notion of habitual residence of a legal person as the place of its main establishment, which must be determined taking into account primarily its centre of management, as well as the centre of its business activities.

[18] G. Stuer, "Réflexions sur le droit applicable à la monnaie scripturale et au virement", *in* coll., *Liber amicorum André Bruyneel*, p. 211, No. 12 and 24).

[19] Financial Collateral Law, Art.8, 9 and 12 and Civil Code, Art. 1254.

Collateral provided to it by a Relevant Clearing Member under the Deed of Charge, would be determined under English law.

If the Settlement Finality Protective Regime applies, then (subject to the reservation below) the enforcement of the security interests created under the Deed of Charge would not be affected by the opening of Insolvency Proceedings or the taking of Reorganisation Measures in relation to the Relevant Clearing Member, because the Settlement Finality Law provides that (i) the rights of a system operator to collateral security provided to it in connection with a system is not affected by insolvency proceedings against the participant and (ii) insolvency proceedings have no retroactive effects on the rights and obligations of a participant arising from, or in connection with, its participation in a system before the moment of opening of such proceedings.

However, in the case of a Relevant Clearing Member that is a credit institution or a stockbroking firm, the enforcement of the security interests created pursuant to the Deed of Charge may be affected by the BRRD regime (see paragraph 3.2.1(b) above).

(d) *For completeness: the Financial Collateral Law*

(i) Introduction

For completeness, and to the extent relevant, if the Deed of Charge constitutes a financial collateral arrangement for the purposes of the Financial Collateral Law, then it will also benefit from the protection of Article 15 of the Financial Collateral Law. Accordingly, the security interest created by the Deed of Charge will remain effective in the context of Insolvency Proceedings or Reorganisation Measures of a Relevant Clearing Member, provided that the Deed of Charge was entered into before the opening of such Insolvency Proceedings or Reorganisation Measures, or that when entering into the Deed of Charge LCH was not aware or should not have been aware of the opening of such Insolvency Proceedings or Reorganisation Proceedings.

However, in the case of a Relevant Clearing Member that is a credit institution or a stockbroking firm, the enforcement of the security interests created pursuant to the Deed of Charge may be affected by the BRRD regime (see paragraph 3.2.1(b) above).

In accordance with Belgian conflicts of laws rules, the conditions for the enforcement against Collateral provided to LCH by a Relevant Clearing Member under the Deed of Charge will be governed by the law of the "relevant account" in the case of securities Collateral, and by the law of the habitual residence of the Relevant Clearing Member in the case of cash Collateral.

(ii) Scope of Article 15 of the Financial Collateral Law

Article 15 of the Financial Collateral provides that "collateral arrangements" and "netting agreements" are valid and enforceable against third parties including in the event of insolvency proceedings, provided that they were entered into before the opening of the insolvency proceedings or that, when they were entered into, the counterparty was not aware and should not have been aware that insolvency proceedings had been opened in respect of the insolvent party.

Article 3 3º of the Financial Collateral Law defines "collateral arrangements" as follows:

> "*the following arrangements, as well as similar arrangements entered into under foreign law: a) pledge agreements; b) transfer title collateral arrangements, including [repos]*"[20].

Article 6 of the Financial Collateral Law further provides:

> "*The conclusion of collateral arrangements (...) must be established in writing, including in electronic form or any other durable means, or by any other legal means accepted in commercial matters. The same applies to the identification of assets that are subject to a collateral arrangement and, with respect to financial instruments, to their delivery*"[21].

[20] Free English translation.

[21] Free English translation.

In accordance with Article 4, the Financial Collateral Law applies to "collateral arrangements" with respect to:

> "*1º financial instruments delivered to the collateral taker or the person acting on its behalf;*
>
> *2º or cash pledged or transferred by agreement to the collateral taker or the person acting on its behalf;*
>
> *3º or banking receivables pledged or transferred by agreement to the collateral taker or the person acting on its behalf.*
>
> *For the application of the first paragraph, 1°, it is sufficient to establish the effective delivery, transfer, holding, registration or any other treatment with the effect that the collateral taker or the person acting on its behalf acquires possession or control over the collateral assets*"[22].

Article 3 1º of the Financial Collateral Law defines "financial instruments" as follows:

> "*the categories of instruments referred to in article 2, 1° of the law of 2 August 2002 relating to the surveillance of the financial sector and financial services, irrespective of whether they are negotiable on the capital market, a right over or relating to such financial instrument, including an intangible co-ownership right on the universality of financial instruments of the same kind within the meaning of article 2, paragraph 3 of the royal decree n° 62 relating to the deposit of fungible financial instruments and the liquidation of transactions on such instruments or article 468, paragraph 5 of the Companies code or article 3, paragraph 1 of the law of 2 January 1991 on the market in public debt securities*

[22] Free English translation.

and monetary policy instruments, or a receivable relating to such a financial instrument"[23].

The "*categories of instruments referred to in article 2, 1° of the law of 2 August 2002 relating to the surveillance of the financial sector and financial services*" are derived from the list of "financial instruments" set out in Section C of Annex I to MiFID II[24]. They comprise the following:

(A) "transferable securities", defined as shares in companies and other securities equivalent to shares in companies, partnerships or other entities, and depositary receipts in respect of shares, bonds or other forms of debt securities, including depositary receipts in respect of such securities, and any other securities giving the right to acquire or sell any such transferable securities or giving rise to a cash settlement determined by reference to transferable securities, currencies, interest rates or yields, commodities or other indices or measures;

(B) money-market instruments, defined as those classes of instruments which are normally dealt in on the money market, such as treasury bills, certificates of deposit and commercial papers (excluding instruments of payment);

(C) units in collective investment undertakings;

(D) certain categories of options, futures, swaps, forward rate agreements and other derivative contracts;

(E) derivative instruments for the transfer of credit risk;

(F) financial contracts for differences; and

(G) emissions allowances.

[23] Free English translation.

[24] Directive 2014/65/UE of the European Parliament and of the Council on markets in financial instruments amending Directive 2002/92/EC and Directive 2011/61/EU, dated 15 May 2014.

Article 3 2º of the Law on Financial Collateral defines "cash" as follows:

> "*the rights arising from funds credited on an account, in any currency, excluding fiducial cash, and similar receivables giving rise to a right to the restitution of money*"[25].

In our view, insofar as the Charged Property comprises "financial instruments" and "cash" (as defined by the Financial Collateral Law) and to the extent that the Charged Property is in the "possession" or "control" of LCH, the security arrangements under the Deed of Charge would constitute a financial collateral arrangement for the purposes of Article 15 of the Financial Collateral Law.

(iii) "Suspect period" regime under the Financial Collateral Law

For completeness, the "suspect period" regime applicable under the Financial Collateral Law is summarised in paragraph 4.1.4 below.

[25] Free English translation.

3.2.3 ***Would LCH have the right to take the actions provided for in 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 affirmative, please identify those specific Insolvency Proceedings and/or Reorganisation Measures to which the answer applies and briefly explain your reasoning.***

The Settlement Finality Law purports to extend the protections of the Settlement Finality Directive to third country systems, as contemplated by Recital (7) of the Settlement Finality Directive[26].

There appears to be a gap in the Settlement Finality Law, as it does not contain any definition of "third country system", but defines the concept of "system" by reference to EU systems, through the use of the same definition as the one set out in the Settlement Finality Directive (*i.e.*, a formal arrangement between three or more participants governed by the law of a Member State chosen by the participants and designated as a system and notified to the European Securities and Markets Authority by the Member State whose law is applicable) (article 1/1, 1° of the Settlement Finality Law).

In our view, in order to assess whether an arrangement is a "third country system" for the purposes of the Settlement Finality Law, one must test the arrangement by reference to the same criteria as those mentioned in article 1/1, 1° of the Settlement Finality Law, but applied *mutatis mutandis*, namely:

— a formal arrangement;

— between three or more participants, excluding the system operator of the system, a possible settlement agent, a possible central counterparty, a possible clearing house or a possible indirect participant, with common rules and standardised arrangements for the clearing, whether or not through a central counterparty, or execution of transfer orders between the participants;

[26] *Doc. Parl.* Chambre, 1998/1999, n° 1999/1, p. 7.

— governed by the law of a third country chosen by the participants; the participants may, however, only choose the law of a third country in which at least one of them has its head office, and

— designated as a system by the third country whose law is applicable, after that third country is satisfied as to the adequacy of the rules of the system.

Therefore, notwithstanding the above gap in the Settlement Finality Law, we believe that post Brexit LCH should qualify as a third country system for the purposes of Articles 2 §4 and 7 §2 of the Settlement Finality Law, if it satisfies the above criteria.

As noted above, the interaction between the Settlement Finality Protective Regime on the one hand, and the Settlement System Governing Law Rule on the other hand, is not clear.

To the extent that the Settlement System Governing Law Rule applies, the impact of Insolvency Proceedings or Reorganisation Measures against a Relevant Clearing Member on its rights and obligations arising from, or in connection with, its participation in the LCH system must be determined under English law.

To the extent that the Settlement Finality Protective Regime applies, the following protections will apply in accordance with the Settlement Finality Law:

- transfer orders and netting are valid and enforceable against third parties even in the event of insolvency proceedings against a participant, provided that transfer orders were entered into the system before the moment of opening of such insolvency proceedings;

- where transfer orders are entered into a system after the moment of opening of insolvency proceedings and are carried out within the business day, as defined by the rules of the system, during which the opening of such proceedings occur, they are valid and enforceable against third parties only if the system operator can prove that, at the time that such transfer orders become irrevocable, it was neither aware, nor should have been aware, of the opening of such proceedings;

- the provisions of Book XX of the Code of Economic Law on transactions entered into during the "suspect period" preceding the

declaration of insolvency will not be allowed to lead to the unwinding of a netting;

- notwithstanding the opening of insolvency proceedings against a participant, the operator of the system may, if the applicable contractual provisions allow it to do so, automatically debit the settlement account of the participant in the event that it fails to fulfil its obligations (in particular for the purpose of clearing the latter's debit balance after netting, thereby enabling the final settlement of the system), and/or automatically withdraw the cash or securities necessary for the fulfilment of the obligations of the participant, in particular with regard to the discharge of the defaulting participant's debit balance in connection with the use of any credit facility granted to the participant, within the limits of the collateral provided as security for the credit facility on the settlement date;

- a transfer order may not be revoked by a participant in a system, nor by a third party, from the moment defined by the rules of that system; and

- insolvency proceedings have no retroactive effects on the rights and obligations of a participant arising from, or in connection with, its participation in a system before the moment of opening of such proceedings.

However, in the case of a Relevant Clearing Member that is a credit institution or a stockbroking firm, the right to take the actions provided for in the Default Rules may be affected by the BRRD regime (see paragraph 3.2.1(b) above).

Under the laws of this jurisdiction, it is not necessary 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.

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

The Belgian bankruptcy law contains voidable preference rules that challenge certain transactions made by or with a bankrupt debtor during the pre-bankruptcy suspect period of up to six months[27]. The following actions and payments are caught by the voidable preference rules:

(a) transactions made without consideration, or at a significant undervalue;

(b) payments made in respect of liabilities that were not yet due and payable;

(c) payments in kind, unless the payment in kind is an agreed enforcement method of a financial collateral arrangement;

(d) all transactions with a counterparty who had knowledge of the insolvency of the debtor;

(e) new security granted for pre-existing debts.

However, the Settlement Finality Law purports to extend the protections of the Settlement Finality Directive to third country systems, as contemplated by Recital (7) of the Settlement Finality Directive[28].

There appears to be a gap in the Settlement Finality Law, as it does not contain any definition of "third country system", but defines the concept of "system" by reference to EU systems, through the use of the same definition as the one set out in the Settlement Finality Directive (*i.e.*, a formal arrangement between three or more participants governed by the law of a Member State chosen by the participants and designated as a system and notified to the European Securities and Markets Authority by the Member State whose law is applicable).

Notwithstanding the above gap in the Settlement Finality Law, we believe that post Brexit LCH should qualify as a third country system for the purposes of

[27] Code of Economic Law, Art. XX.111, XX.112 and XX.114.

[28] *Doc. Parl.* Chambre, 1998/1999, nº 1999/1, p. 7.

the Settlement Finality Law if it satisfies the criteria for an EU system, *mutatis mutandis* (see paragraph 3.2.3 above).

As noted above, the interaction between the Settlement Finality Protective Regime on the one hand, and the Settlement System Governing Law Rule on the other hand, is not clear.

If the Settlement System Governing Law Rule applies, then the question whether, in the event of any Insolvency Proceedings being opened or any Reorganisation Measures being opened against a Relevant Clearing Member, any Contracts or any payments and deliveries thereunder or the taking Collateral or the delivery of additional Collateral in respect of Contracts could be avoided or challenged on the basis of rules relating to the voidness, voidability or unenforceability of legal acts detrimental to all creditors would be governed by English law (and the above Belgian insolvency rules would therefore not apply).

If the Settlement Finality Regime applies, then the above Belgian insolvency rules would not apply either, because the Settlement Finality Law provides that (i) the relevant provisions of Book XX of the Code of Economic Law may not lead to the unwinding of a netting, (ii) the rights of a system operator to collateral security provided to it in connection with a system is not affected by insolvency proceedings against the participant and (iii) insolvency proceedings have no retroactive effects on the rights and obligations of a participant arising from, or in connection with, its participation in a system before the moment of opening of such proceedings.

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

The general rules on set-off are laid down in the Civil Code[29]. Subject to specific exceptions, the Financial Collateral Law offers broad protection for contractual close-out netting arrangements in the insolvency of a party[30].

However, as explained above, we believe that, post Brexit, LCH should qualify as a third country system for the purposes of the Settlement Finality Law if it

[29] Civil Code, Art. 1244; Judicial Code, Art. 1333 *et seq*.

[30] Financial Collateral Law, Art. 14.

satisfies the criteria for an EU system, *mutatis mutandis* (see paragraph 3.2.3 above).

As noted above, the interaction between the Settlement Finality Protective Regime on the one hand, and the Settlement System Governing Law Rule on the other hand, is not clear.

If the Settlement System Governing Law Rule applies, then the enforceability of the netting arrangements provided for in the Arrangements is governed by English law (and Belgian substantive rules on netting are not applicable).

If the Settlement Finality Protective Regime applies, then the relevant rules protecting the operation of netting arrangements (summarised in paragraph 0 above) will apply instead of the above Belgian substantive rules on netting.

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

Claims may be filed in Insolvency Proceedings in any currency in which they are denominated. In the case of a bankruptcy or a liquidation, an unsecured net claim filed in a foreign currency will be converted, for the purposes of measuring *pro rata* distributions between creditors, at the rate of exchange prevailing on the date of commencement of the Insolvency Proceedings or, if applicable, at the rate set by agreement between the parties[31].

The enforceability in Belgium of monetary claims is not limited to claims denominated in euro. Judgments from the Belgian courts ordering the payment of a sum of money, however, may only be expressed in euro or in the currency of an OECD member state[32]; claims denominated in another currency will be converted into euro by the courts.

[31] A. Zenner, *Dépistage, faillites & concordats*, No. 410; A. Cloquet, *Les concordats et la faillite*, *Novelles*, t. IV, No. 1725.

[32] Law of 30 December 1885, Art. 3.

3.3 Client Clearing

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

If, and to the extent that, you consider such an Exempting Client Clearing Rule to be available, please (i) assume for the purposes of answering the following Questions that LCH will rely upon the existence of the relevant Exempting Client Clearing Rule and will not require those Relevant Clearing Members to which that Rule applies to enter into a Security Deed; and (ii) ignore Questions 3.3.8 to 3.3.10.

In cases where you do not consider an Exempting Client Clearing Rule to be available, please: (i) assume for the purposes of answering the following Questions that LCH will require Relevant Clearing Members to enter into a Security Deed; (ii) assume that 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 law of any jurisdiction(s) other than the Relevant Jurisdiction which you consider to be relevant to that matter; and (iii) provide a response to Questions 3.3.8 to 3.3.10.

In this jurisdiction there is no law, regulation or statutory provision which would qualify as an Exempting Client Clearing Rule.

However, as explained above, we believe that post Brexit LCH should qualify as a third country system for the purposes of Articles 2 §4 and 7 §2 of the Settlement Finality Law if it satisfies the criteria for an EU system, *mutatis mutandis* (see paragraph 3.2.3 above).

Article 7 §2 of the Settlement Finality Law provides that in the event of insolvency proceedings against a Belgian participant in a payment and securities settlement system governed by the law of another EU member or third country, the rights and obligations arising from, or in connection with, the participation of that Belgian participant in the system shall exclusively be determined by the foreign law governing the system. The rights of LCH, following the commencement of Insolvency Proceedings or Reorganisation Measures of a Relevant Clearing Member, (i) to port the Client Contracts and Account Balance

of a Clearing Client to a Backup Clearing Member, or (ii) to return the Client Clearing Entitlement to the relevant Clearing Client or to the Defaulter for the account of such client, are set out in the Agreements and as such constitute "rights and obligations arising from, or in connection with, the participation in a payment and securities settlement system" for these purposes. The impact of Insolvency Proceedings or Reorganisation Measures against a Relevant Clearing Member on these arrangements must therefore be determined under English law as the governing law of the LCH system.

We understand that English substantive insolvency law (in particular Part VII of the Companies Act 1989, "**Part VII**") would give effect to the provisions in the LCH Rules entitling LCH to either port the Client Contracts and Account Balance of a Clearing Client to a Backup Clearing Member or to return the Client Clearing Entitlement to the relevant Clearing Client or to the Defaulter for the account of such Clearing Client, irrespective of the existence and/or enforceability of a Security Deed entered into between the Clearing Member and its Clearing Clients. Part VII would therefore operate as an Exempting Client Clearing Rule for English law purposes, as provided for in the Clifford Chance English law Opinion Letter in respect of the LCH Limited EMIR-compliant model dated 1 December 2020 (the "**English law Opinion**")

For completeness, to the extent relevant, the EMIR Refit Regulation amends Article 39 of EMIR to include a new Article 39(11) [33], which provides that Members States' national insolvency laws must not prevent a CCP from porting the assets and positions of the defaulting clearing member to a backup clearing member or the making of leapfrog payments to clearing clients in accordance with Article 48(5), (6) and (7) of EMIR. Article 39(11) of EMIR is in force and is directly applicable in Belgium.

[33] Article 1(11) of the EMIR Refit Regulation.

3.3.2 ***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?***

In the absence of Insolvency Proceedings or Reorganisation Measures, to the extent Belgian law is applicable, Belgian law will in principle give full effect to whatever contractual provisions parties may have agreed between themselves with regard to porting of positions and assets[34].

3.3.3 ***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?***

In the absence of Insolvency Proceedings or Reorganisation Measures, to the extent Belgian law is applicable, Belgian law will in principle give full effect to whatever contractual provisions parties may have agreed between themselves with regard to close-out and leapfrogging of net payments and assets to clearing clients[35].

[34] Civil Code, Art. 1134.

[35] Civil Code, Art. 1134.

3.3.4 ***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 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 impact of Insolvency Proceedings against a Relevant Clearing Member on the arrangements with respect to porting of positions must, in accordance with the conflict of law rule set forth by the Settlement Finality Law, be determined under English substantive law. Please refer to paragraph 3.3.1 above.

3.3.5 ***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?***

The impact of Insolvency Proceedings against a Relevant Clearing Member on the arrangements with respect to close-out and leapfrogging of net payments to clearing clients must, in accordance with the conflict of law rule set forth by the Settlement Finality Law, be determined under English substantive law. Please refer to paragraph 3.3.1 above.

3.3.6 ***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 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?***

The impact of Reorganisation Measures against a Relevant Clearing Member on the arrangements with respect to porting of positions must, in accordance with the conflict of law rule set forth by the Settlement Finality Law, be

determined under English substantive law. Please refer to paragraph 3.3.1 above.

3.3.7 ***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?***

The impact of Reorganisation Measures against a Relevant Clearing Member on the arrangements with respect to close-out and leapfrogging of net payments to clearing clients must, in accordance with the conflict of law rule set forth by the Settlement Finality Law, be determined under English substantive law. Please refer to paragraph 3.3.1 above.

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

We understand that Part VII operates as an Exempting Client Clearing Rule for English law purposes, as provided for in the English law Opinion, and consequently, in accordance with the Instructions, we have not provided an answer to this question.

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

We understand that Part VII operates as an Exempting Client Clearing Rule for English law purposes, as provided for in the English law Opinion, and consequently, in accordance with the Instructions, we have not provided an answer to this question.

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

We understand that Part VII operates as an Exempting Client Clearing Rule for English law purposes, as provided for in the English law Opinion, and consequently, in accordance with the Instructions, we have not provided an answer to this question.

3.3.11 ***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 relevant to the questions addressed in this opinion which we wish to draw to your attention.

3.4 Settlement Finality

3.4.1 ***If your responses to the Evolution Phase 1 questionnaire confirmed that local law in your jurisdiction afforded protections to LCH as contemplated in Recital 7 of the Settlement Finality Directive (or if there is uncertainty on which protections may apply, counsel should advise on the points of certainty and respond to the remainder of this question accordingly), will the analysis in relation to settlement finality protections be the same as in the existing Opinion? Would protections afforded to a third country system be equivalent to those LCH currently benefits from under the EU Settlement Finality Directive?***

For jurisdictions where a change in law is contemplated to implement Recital 7 (e.g. France), please provide a status update on the change in law and advise if this is likely to cover a third country CCP, such as LCH.

See paragraphs 3.2.2 and 3.2.3 above.

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

The Settlement Finality Law purports to extend the protections of the Settlement Finality Directive to third country systems, as contemplated by Recital (7) of the Settlement Finality Directive[36].

There appears to be a gap in the Settlement Finality Law, as it does not contain any definition of "third country system", but defines the concept of "system" by reference to EU systems, through the use of the same definition as the one set out in the Settlement Finality Directive (*i.e.*, a formal arrangement between three or more participants governed by the law of a Member State chosen by the participants and designated as a system and notified to the European Securities and Markets Authority by the Member State whose law is applicable).

Notwithstanding the above gap in the Settlement Finality Law, we believe that post Brexit LCH should qualify as a third country system for the purposes of the Settlement Finality Law if it satisfies the criteria for an EU system, *mutatis mutandis* (see paragraph 3.2.3 above).

As noted above, the interaction between the Settlement Finality Protective Regime on the one hand, and the Settlement System Governing Law Rule on the other hand, is not clear.

If the Settlement System Governing Law Rule applies, then the impact of Insolvency Proceedings or Reorganisation Measures against a Relevant

[36] *Doc. Parl.* Chambre, 1998/1999, nº 1999/1, p. 7.

Clearing Member on the finality of settlement of transfers of funds or securities (or both) from the Relevant Clearing Member to LCH must be determined under English law.

If the Settlement Finality Protective Regime applies, then the relevant rules on the finality of settlement of transfers of funds or securities (or both) (summarised in paragraph 0 above) will apply.

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

As explained above, we believe that post Brexit LCH should qualify as a third country system for the purposes of the Settlement Finality Law if it satisfies the criteria for an EU system, *mutatis mutandis* (see paragraph 3.2.3 above).

4. QUALIFICATIONS

The opinions in this opinion letter are subject to the following qualifications.

4.1 *Deed of Charge*

4.1.1 Financial collateral arrangements – the "possession" or "control" requirement

For the purposes of the opinions expressed in paragraph 3.2.2(d) (*For completeness: the Financial Collateral Law*) above, a financial collateral arrangement for the purposes of Article 15 of the Financial Collateral Law requires that the relevant financial collateral is on the "possession or control" of the collateral taker, which in this case is LCH.

In accordance with Article 4 § 1 of the Financial Collateral Law:

> "*The delivery in possession of account held financial instruments may be established notably by their inscription to the credit of a special account opened in the name of the collateral giver or the collateral taker or a third party who holds the collateral on behalf of the collateral taker. The fact that the collateral assets are registered in the books of an intermediary does not prevent the latter from acting as a party with*

respect to those assets. Where the financial instruments are registered to the credit of a special account opened in the name of the collateral giver, the collateral taker or a third party acting on behalf of the latter, the possession or control requirement is not prejudiced if, until further notice from the collateral taker or the third party acting on its behalf, the collateral giver maintains the disposal rights defined in the collateral arrangement.[37]"

On the basis of the above, to the extent that Belgian law is applicable, and whilst there is little legal guidance on this point, we are of the view that in light of the fact that the Charged Property are held by LCH (either held by a Clearance System (as defined in the Deed of Charge) on behalf of, for the account of, to the order of or under the control or direction of LCH or under the control or direction of a Custodian Bank (as defined in the Deed of Charge) for the account of the Clearing House)), the relevant conditions that have to be met in order to establish "possession" or "control" for the purposes of Article 15 of the Financial Collateral Law are present.

4.1.2 BRRD

With respect to the impact of BRRD as implemented in Belgium by the Banking Law, see paragraph 3.2.1(b) above.

4.1.3 Judicial reorganisation measures

For the purposes of the opinions expressed in paragraph 3.2.2(d) (*For completeness: the Financial Collateral Law*) above, under Belgian law, after the opening of judicial reorganisation proceedings in respect of a Relevant Clearing Member, enforcement of cash Collateral is not permitted unless there is a payment default (Article 4 of the Financial Collateral Law). As mentioned above, judicial reorganisation proceedings are not available to credit institutions, insurance companies and certain other categories of regulated financial institutions.

By way of exception to the above, in accordance with Article 4 of the Financial Collateral Law, if the provider of the security is a public sector or financial entity and the beneficiary of the security is itself also a public sector or financial entity (noting that the definition of "public sector or financial entity" comprises "central counterparties"), enforcement of security over cash Collateral is

[37] Free English translation.

permitted notwithstanding the opening of judicial reorganisation proceedings, irrespective of whether there is a payment default or not.

We believe that from the Transition End Date onwards LCH should qualify as a "central counterparty" for these purposes as it has become a recognised third country CCP in accordance with Article 25 of EMIR.

4.1.4 Voidness of delivery of Collateral upon bankruptcy

For the purposes of the opinions expressed in paragraph 3.2.2(d) (*For completeness: the Financial Collateral Law*) above, collateral provided under the Deed of Charge may be vulnerable to the application of the following "suspect period" rules relating to the voidness, voidability or unenforceability of legal acts detrimental to all the creditors. "Suspect period" rules apply only in the case of a bankruptcy; there are no rules of that type in the case of other forms of Insolvency Proceedings or in the case or Reorganisation Proceedings.

Collateral provided under the Deed of Charge may be voidable, upon the bankruptcy of the Relevant Clearing Member, in the following circumstances:

(a) If it is provided during the suspect period as security for pre-existing Contracts[38]. It will not be voidable on this ground, however, if it is provided during the suspect period but pursuant to an undertaking to do so that was entered into prior to the suspect period with a view to ensuring, during the life of one or more transactions, a balance between the respective obligations of the parties[39]. Collateral delivered following margin calls to reflect changes to the settlement to market or marked to market value of the underlying Contracts should in principle satisfy this condition and therefore be immune against avoidance on this ground, but the assessment of this question may be affected by the factual circumstances of a particular case; further, the question may be debatable where the obligation to provide Collateral is triggered by circumstances or events other than changes in the settlement to market or marked to market value of the underlying Contracts.

(b) If it constitutes an abnormal transaction entered into in the knowledge that the transaction would prejudice the creditors of the Relevant

[38] Code of Economic Law, Art. XX.111 3°; law of 15 December 2004 on financial collateral, Art. 15 §2, al. 2.

[39] Financial Collateral Law, Art. 3, 9° and 16 §1.

Clearing Member[40]. The delivery of Collateral pursuant to the provisions of the Collateral Arrangements does not in itself appear to us as "abnormal" for the purposes of this rule of bankruptcy law, but the assessment of the abnormal character of such an arrangement may be affected by the factual circumstances of a particular case.

(c) If it is provided during the suspect period and entails a significant undervalue for the Relevant Clearing Member[41]. The delivery of Collateral pursuant to the provisions of the Collateral Arrangements does not in itself appear to us as entailing a significant undervalue for the purposes of this rule of bankruptcy law, but the assessment of this question may be affected by the factual circumstances of a particular case.

(d) If it is provided during the suspect period and the recipient of collateral at the time knew that the provider of collateral was already in a situation of cessation of payments[42], unless it is provided pursuant to an undertaking to do so that was entered into prior to the suspect period with a view to ensuring, during the life of one or more transactions, a balance between the respective obligations of the parties[43]. Collateral delivered following margin calls to reflect changes to the settlement to market or marked to market value of the underlying Contracts should in principle satisfy this condition and therefore be immune against avoidance on this ground, but the assessment of this question may be affected by the factual circumstances of a particular case; further, the question may be debatable where the obligation to provide Collateral is triggered by circumstances or events other than changes in the settlement to market or marked to market value of the underlying Contracts.

The substitution of Collateral during the suspect period will not invalidate an otherwise valid transfer, assuming that the exchanged assets are of no greater value than the assets that they are replacing and that there is no time gap between

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40 Code of Economic Law, Art. XX.114; Financial Collateral Law, Art. 16 §3; cass., 15 March 1985, Pas., 1985, I, 875; 27 February 1998, Pas., 1998, p. 109.

41 Code of Economic Law, Art. XX.114.

42 Code of Economic Law, Art. XX.112.

43 Financial Collateral Law, Art. 3, 9° and 16 §1.

the restitution of the "old" assets and the delivery of the "new" assets[44]. If these conditions are not satisfied and if the substitution takes place during the suspect period preceding the bankruptcy of the provider of collateral, the new collateral may be voidable on the grounds that it constitutes new security for pre-existing transactions (see above).

4.1.5 Ranking

Under Belgian law, financial intermediaries and clearing and settlement systems have a statutory lien over any securities and cash they hold from clients as security for the payment of any transaction and handling costs due by the client[45].

4.1.6 Application of enforcement proceeds

The laws of this jurisdiction provide for an obligation:

(a) to apply the proceeds of the Collateral first against interest and secondly against principal[46]; and

(b) to return any excess proceeds of enforcement to the collateral provider.

It is uncertain whether these two rules are matters of substantive law and do not apply to the securities Collateral, the enforcement against which is governed by the law of the "relevant account" (see paragraph 3.2.2 above), or are matters of procedural enforcement and may be applied more broadly by the courts of this jurisdiction.

4.2 *Close-out netting*

4.2.1 *Abuse of right.* The courts have developed a body of case law to the effect that rights may not be exercised in an abusive manner, and a party may be denied the right to invoke a contractual right if doing so would be abusive[47]. It is unlikely in fact that the exercise of a right of set-off could ever be considered abusive, but the exercise of a right to terminate or close out a Contract might be susceptible of abuse. As to conflicts of laws, however, we believe that these

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44 Cass., 12 November 1914, *Pas.*, 1915-1916, I, 124; Financial Collateral Law, Art. 16 §2.

45 Law of 2 August 2002 on the supervision of the financial sector and the financial services, Art. 31.

46 Financial Collateral Law, Art.8, 9 and 12 and Civil Code, Art. 1254.

47 For example, Cass., 8 February 2001, *Pas.*, 2001, p. 244; 6 January 2011, with concl. Adv. Gen. Henkes, *juridat*, C.09.0624.F.

issues must be regarded as being contractual matters, that a Belgian court should apply the law that governs the Agreements, and that Belgian law should thus not be relevant to an allegation of abusive termination pursuant to the Agreements.

4.2.2 *Liquidated damages and penalties.* Belgian law allows contractual arrangements providing for liquidated damages (*clause pénale / strafbeding*), but gives the courts the power to reduce the agreed amount of liquidated damages if such amount manifestly exceeds a genuine pre-estimate by the parties of the loss to be suffered in the event of a breach[48]. The determination of a termination amount upon close-out of the Contracts may fall under these rules. As to conflicts of laws, however, we believe that these issues must be regarded as being contractual matters, that a Belgian court should apply the law that governs the Agreements, and that Belgian law should thus not be relevant to an allegation that a termination payment determined in accordance with the Agreements is excessive.

4.2.3 *Grace periods.* The courts have the power to grant periods of grace for the performance of its obligations to a debtor who has acted in good faith[49]. It is uncertain whether this power is a matter of substantive law and can only be exercised if an agreement is governed by Belgian law, or is a procedural matter and can always be exercised by the Belgian courts irrespective of the governing law of an agreement.

4.2.4 *Mandatory rules and rules of public policy.* Certain rules of law of this jurisdiction are mandatory (*impératives / van dwingend recht*) rules or relate to public policy (*ordre public / openbare orde*), and overrule any contractual provision with which they would be inconsistent. The Arrangements do not conflict with any such mandatory rules or rules of public policy.

4.2.5 *Contingent or unascertained obligations.* If a party is subject to insolvency proceedings in this jurisdiction, the courts may not give effect to the close-out netting arrangements of the Agreements to the extent that these arrangements seek to allow set-off of an obligation owed to that party against obligations of that party that are merely contingent or unascertained.

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48 Civil Code, Art. 1231.

49 Civil Code, Art. 1244; Judicial Code, Art. 1333 *et seq*.

4.2.6 *Excessive delay.* The courts of this jurisdiction may not allow the operation of the close-out netting arrangements of the Agreements to delay the payment of a termination amount beyond a reasonable period of time[50].

This opinion letter is given for the exclusive benefit of the addressee. In this opinion we do not assume any obligation to notify or inform you of any developments subsequent to its date that might render its content untrue or inaccurate in whole or in part at such time. It may not, without prior written consent, be relied on by any other person. We consent to a copy of this opinion letter being made publicly available on the addressee's website and being shown to: (i) actual and prospective clearing members and clearing clients; (ii) relevant regulators; and/or (iii) legal counsel appointed by the addressee or any person listed in (i) above to advise on matters of the laws of other jurisdictions, in each case for information purposes only and solely on the basis that we assume no responsibility to any such parties as a result or otherwise.

Clifford Chance

[50] See the discussion of the concept of "abuse of right" in paragraph 4.1.1.