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1 January 2021

Dear Sirs

Project Evolution Phase III (Germany)

You have asked us to provide this opinion in respect of the laws of Germany ("**this jurisdiction**") in response to certain specific questions in relation to membership, insolvency, security, set-off and netting and client clearing with respect to entities incorporated in Germany (the "**Relevant Jurisdiction**") becoming clearing members of LCH Limited ("**LCH**") (each a "**Relevant Clearing Member**") and entering into the Clearing Membership Agreement, the Deed of Charge, the Security Deed, and the Rulebook (all as defined in paragraph 1.9 below).

The relevant questions are set out in full in paragraph 3 of this Opinion Letter together with the corresponding responses.

This Opinion Letter is given in respect of German Clearing Members which are Companies and hold the requisite licence to act as Credit Institutions or Financial Services Institutions each incorporated in, and acting through their offices in Germany.

For purposes of this Opinion Letter,

"**Company**" means a stock corporation (*Aktiengesellschaft*, "**AG**") established under the German Stock Corporation Act (*Aktiengesetz*, "**AktG**"), or a European public limited liability company (*Societas Europaea*, "**SE**") established under the Regulation (EC) No 2157/2001 on the Statute for a European Company (SE) ("**SER**")[1] or a limited liability company (*Gesellschaft mit beschränkter Haftung*, "**GmbH**") established under the German Act on Limited Liability Companies (*Gesetz betreffend die Gesellschaften mit beschränkter Haftung*);

"**Credit Institution**" means a credit institution (*Kreditinstitut*) within the meaning of section 1 para 1 of the German Banking Act (*Kreditwesengesetz*, "**KWG**") established as a Company under German private law or established under German public law as a separate legal entity (*juristische Person des öffentlichen Rechts*) in the form of a corporation (*Körperschaft des öffentlichen Rechts,* "**KöR**") or an agency with full legal capacity (*rechtsfähige Anstalt des öffentlichen Rechts*, "**AöR**");[2] and

"**Financial Services Institution**" means a financial services institution (*Finanzdienstleistungsinstitut*) within the meaning of section 1 para 1a KWG established as a Company.

1. INTRODUCTION, TERMS OF REFERENCE

1.1 Formal statement

This opinion letter (the "**Opinion Letter**") contains formal statements of opinion as to German law on the matters set out in paragraph 3 (Opinion) below. It is based on our understanding of LCH's clearing services as they are described in the Opinion Documents listed in paragraph 1.9 below, and is subject to assumptions set out in paragraph 2 (Assumptions) and to the qualifications set out in paragraph 4 (Qualifications). The opinions given in this Opinion Letter are strictly limited to the specific questions raised by you as set out in paragraph 3 (Opinion) hereafter and do not extend to any other matters. We have assumed that all matters which are or could

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[1] According to Article 10 SER, subject to the SER, an SE is treated in every EU member state as if it were a stock corporation formed in accordance with the law of the EU member state in which it has its registered office. Therefore, the provisions of the AktG apply to SEs having their registered office in Germany unless special provisions of SER prevail.

[2] We do not opine on the enforceability of the liquidation, set-off, netting and credit support provisions if the relevant laws or statutes of Credit Institutions established under public law provide for specific limitations on such rights and obligations.

be material in the context of our delivery of this Opinion Letter have been disclosed to us.

1.2 No advice

We have not been responsible for advising any party to the Opinion Documents. We have been instructed to issue this Opinion Letter and the delivery of this Opinion Letter to any other person to whom a copy of this Opinion Letter may be disclosed pursuant to paragraph 5 does not evidence the existence of any relationship of client and lawyer between us and such person.

1.3 Scope of examination and investigation

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:

1.3.1 any liability to tax as a result of or in connection with the Opinion Documents, or the tax treatment of any transaction or the tax position of any party thereto;

1.3.2 any regulatory or accounting matters except to the extent that we address relevant provisions of Regulation (EU) No 648/2012 of 4 July 2012 on OTC derivatives, central counterparties and trade repositories ("**EMIR**") where relevant for assessing the effects of Article 102b of the German Introductory Act to the Insolvency Code (*Einführungsgesetz zur Insolvenzordnung*, "**EGInsO**");

1.3.3 any matters of fact or the reasonableness of any statements of opinion or intention expressed in relation to the Opinion Documents, including any facts, events or circumstances arising as a result of the execution of any related documents by the parties thereof or the performance of the parties' obligations deriving therefrom;

1.3.4 the validity and enforceability of any of the Opinion Documents (other than set out in paragraph 3 below);

1.3.5 the enforceability of any net obligation resulting from any netting or set-off;

1.3.6 any laws of any jurisdiction other than Germany, including jurisdictions in which our firm has an office or correspondents;

1.3.7 German credit institutions holding a licence as a covered bond bank (*Pfandbriefbank*) with respect to any transactions relating to or included in the

cover register (*Deckungsregister*) and we do not give an opinion on general regulatory restrictions under the German Covered Bond Act (*Pfandbriefgesetz*); and

1.3.8 with respect to obligations and assets otherwise allocated by a credit institution to a specific asset or cover pool as required under applicable statutory law.[3]

1.4 Enforceability

In this Opinion Letter, references to the word "**enforceable**" and cognate terms are used to refer to the ability of a party to exercise its contractual rights in accordance with their terms and without risk of successful challenge. We do not opine on the availability of any judicial remedy or on the factual or commercial success of any enforcement measures.

1.5 German law

This Opinion Letter is confined to matters of German law in force as at the date on which this Opinion Letter is given (including any European Union regulations (*Verordnungen*) directly applicable in Germany), as applied and construed according to published court decisions in Germany. We express no opinion on European Union law as it affects or would be applied in any jurisdiction other than Germany.

1.6 No updating

We assume no duty to update this Opinion Letter or inform LCH or any other person to whom a copy of this Opinion Letter may be communicated of any change in German law (including, in particular, applicable court decisions), or the legal status of any party to the Opinion Documents, or any other circumstance that occurs, or is disclosed to us, after the date on which this Opinion Letter is given, which might have an impact on the opinions given in this Opinion Letter.

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[3] See section 13 para 3 of the Act on the Landwirtschaftliche Rentenbank (*Gesetz über die Landwirtschaftliche Rentenbank*), section 9 para 4 of the Act on the Conversion of the Deutsche Genossenschaftsbank (*Gesetz zur Umwandlung der Deutschen Genossenschaftsbank*) and section 7 para 4 of the Act on the Conversion of the Deutsche Siedlungs- und Landesrentenbank into a Stock Corporation (*Gesetz über die Umwandlung der Deutschen Siedlungs- und Landesrentenbank in eine Aktiengesellschaft*) and section 1 para 1 of the Act relating to the Industriekreditbank Aktiengesellschaft (*Gesetz betreffend die Industriekreditbank Aktiengesellschaft*).

1.7 Date

This Opinion Letter is given as of 1 January 2021.

1.8 Interpretation

The opinions given in this Opinion Letter express and describe German legal concepts in the English language rather than in their original form and such expressions and/or descriptions may not be fully identical in their meaning to the underlying German law concepts. Any issues of interpretation arising in respect of the Agreement or the opinions given in this Opinion Letter will be determined by the German courts in accordance with German law and we express no opinion on the interpretation that the German courts may give to any such expressions or descriptions.

Translations of German legal provisions into English are non-official translations and are provided by us for convenience only. The German version is the only binding version and German courts and authorities will have regard only to such German version.

For the avoidance of doubt, the point in time of formal commencement of Insolvency Proceedings (i.e. the opening of Insolvency Proceedings) is in all likelihood not the point in time in which a party is insolvent.

1.9 Documents reviewed

For the purposes of preparing our opinion we have reviewed electronic versions of the following documents as instructed:

1.9.1 the General Regulations dated 12 November 2020, the Default Rules dated 12 November 2020 and the Settlement Finality Regulations dated 10 December 2019, each as published on LCH's website ("**Rulebook**"),

1.9.2 the Clearing Membership Agreement (as defined in the Rulebook) which is substantially in the form appended as Appendix 1 of this opinion letter (the "**Clearing Membership Agreement**"),

1.9.3 a security deed entered into by a Clearing Member in favour of its Clearing Clients in the form of the Deed of Charge set out in Appendix 2 (the "**Security Deed**"), and

1.9.4 a deed of charge entered into between a Clearing Member and LCH in respect of all Charged Property transferred to LCH by that Clearing Member which is substantially in the form of the Deed of Charge set out in Appendix 3 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) (the "**Deed of Charge**" and, together with the Clearing Membership Agreement and the Security Deed, the "**Agreements**").

The documents referred to in paragraphs 1.9.1 to 1.9.4 are referred to as the "**Opinion Documents**".

1.10 Defined terms

Unless otherwise defined herein, terms defined under the Opinion Documents shall have the meaning ascribed to such terms in the Opinion Documents.

2. ASSUMPTIONS

We assume the following:

2.1 The Opinion Documents and Contracts have been validly entered into between all parties and incorporated and form part of the legal relationship between LCH and its Clearing Members.

2.2 The Opinion Documents and Contracts are enforceable in accordance with their terms (other than those provisions of the Opinion Documents on which we opine with respect to matters of German law).

2.3 Each party is, and will continue to be, a validly existing legal entity with capacity, power and authority, under all applicable law(s), to enter into and to exercise its rights and to perform its obligations in connection with Opinion Documents.

2.4 Each party has obtained, complied with the terms of and maintained all authorisations, approvals, licences and consents required to enable it lawfully to enter into and perform its obligations under the Opinion Documents and Contracts and to ensure the legality, validity, enforceability or admissibility in evidence of the Opinion Documents in Germany.

2.5 The Opinion Documents and each Contract have been properly authorised, executed and delivered by each party in accordance with all applicable laws.

2.6 The Opinion Documents and each Contract have been entered into, and each of the Contracts referred to therein is carried out, by each of the parties thereto in good faith, for the benefit of each of them respectively, on arms' length commercial terms and for the purpose of carrying on, and by way of, their respective businesses.

2.7 Each party is at all relevant times solvent and not subject to any regulatory pre-insolvency, reorganisation or insolvency proceedings under the laws of any jurisdiction.

2.8 There is no current or pending stoppage of payment situation (including German law *Zahlungsunfähigkeit*), no status of over-indebtedness (including German law *Überschuldung*) and no reasons justifying a filing for the opening of insolvency proceedings (including on a voluntary basis) (*drohende Zahlungsunfähigkeit*) in respect of any Relevant Clearing Member and that no Relevant Clearing Member is subject to any regulatory pre-insolvency, reorganisation or insolvency proceedings under the laws of any jurisdiction as of the date of this opinion. Each of the Opinion Documents is entered into by the parties prior to the opening of any insolvency or bankruptcy proceedings against either party.

2.9 None of the parties is entitled to claim in relation to itself or its assets immunity from suit, attachment, execution or other legal process. To the extent any entity established under German public law enters into the Opinion Documents or Contracts, the execution of such agreement constitutes, and the exercise of that party's rights and performance of its obligations thereunder will constitute, private and commercial acts done and performed for private and commercial purposes.

2.10 Any Collateral provided in connection with the Opinion Documents will exclusively consist of either cash or securities. Securities will be collectively held (*girosammelverwahrt*) or dematerialised securities booked to an account (*Buchrechte*).

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

2.12 To the extent any transfers of cash or securities or the creation of security interests over, cash or securities, are subject to mandatory property laws (*Sachenrecht*), such property laws are complied with.

2.13 The pledges granted and the outright title transfers made by Clearing Members under the Opinion Documents to LCH are made over accounts held in England and/or assets booked on accounts held in England, are valid, and the requirements of the relevant applicable law governing the creation, transfer and/or enforcement of these pledges and title transfers are complied with, under all applicable laws (other than this jurisdiction).

2.14 There are no rights of third parties in respect of the assets comprising the Collateral nor any other impediments which would in any way affect the transfer of the Collateral as contemplated by the Opinion Documents.

2.15 That none of the parties qualifies as a consumer (*Verbraucher*) within the meaning of section 13 German Civil Code (*Bürgerliches Gesetzbuch*, "**BGB**"), i.e. a natural person entering into a legal transaction for a purpose which belongs neither to its commercial business nor to its self-employed business, but qualifies – as appropriate – as a merchant (*Kaufmann*) within the meaning of section 1 German Commercial Code (*Handelsgesetzbuch*, "**HGB**") or as an entrepreneur (*Unternehmer*) within the meaning of section 14 BGB, i.e. any natural or legal person or partnership entering into a legal transaction in the course of its commercial business or its self-employed business.

2.16 There is no other agreement, instrument, arrangement or dealing between any of the parties to the Opinion Documents and Contracts which modifies, supersedes or affects the Opinion Documents and Contracts.

2.17 The obligations assumed under the Opinion Documents and Contracts are mutual between the parties, in the sense that the parties are each individually and solely liable as regards obligations owing by each other and are solely entitled to the benefit of obligations owed to each other, respectively. Mutuality (*Gegenseitigkeit*) generally exists where each party is individually and solely liable as regards obligations owed by it and is solely entitled to the benefit of obligations owed to it. Circumstances in which the requisite mutuality is missing include, without limitation, where a party is acting as agent for another person, or is a trustee, or in respect of which a party has a joint interest (including partnership) or such in respect of which a party's rights or obligations or any interest therein have been assigned, charged or transferred (whether in whole or in part) whether unilaterally, by agreement or by operation of law.

3. OPINION

On the basis of the foregoing terms of reference and assumptions and subject to the qualifications set out under paragraph 3.5 below we are of the following opinions in response to specific questions which are set out in italics:

3.1 Membership

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

There are no specific statutory limitations or regulatory requirements which would limit the capacity of an appropriately authorised Relevant Clearing Member to enter into the Agreements.

The activities of the Relevant Clearing Member may, however, be subject to licence requirements under section 32 para 1 KWG. To the extent a Relevant Clearing Member purchases or sells financial instruments (such as OTC derivatives) in its own name for the account of Clients, it would conduct principal broking services (*Finanzkommissionsgeschäft*) (section 1 para 1 sentence 2 no. 4 KWG). Furthermore, to the extent the Relevant Clearing Member either keeps securities in safe custody or administers securities for Clients, such activities would constitute licensable safe custody business (*Depotgeschäft*) (section 1 para 1 sentence 2 no. 5 KWG), which is subject to a licence requirement. Since the Opinion Documents exclusively deal with clearing, performance by a Relevant Clearing Member of the obligations under the Opinion Documents alone and in itself would not trigger licence requirements for investment brokering (*Anlagevermittlung*) under section 1 para 1a sentence 2 no. 1 KWG or other financial services under the KWG.[4] For the

[4] Licenseable financial services are, among others, investment advice (section 1 para 1a sentence 2 no. 1a KWG, *Anlageberatung*), contract broking (section 1 para 1a sentence 2 no. 2 KWG, *Abschlussvermittlung*), portfolio management (section 1 para 1a sentence 2 no. 3 KWG, *Finanzportfolioverwaltung*) and own account trading (section 1 para 1a sentence 2 no. 4 KWG, *Eigenhandel*). A licence for own account trading pursuant to section 32 para. 1a KWG is not required, if own account trading on German exchanges or trading venues is conducted by non-EEA entities as participants or members of such exchange or trading venue (the "**Own Account Exemption**"). The Own Account Exemption will apply until the European Securities and Market Authority (ESMA) publishes a decision on a non EEA-entity's application to be entered in ESMA's register of third-country firms pursuant to Article 48 MiFIR. The licence requirements for own account trading are triggered only where the third country entity provides licensable banking business and investment services and holds a German banking licence pursuant to section 32 para. 1 KWG. Mere own account trading by non-EEA entities with counterparties based in Germany does not trigger licence requirements, including where such entity conducts banking business or provides investment services under a BaFin waiver pursuant to section 2 para. 5 KWG. This is because, in contrast to own account dealing, own account trading does not include any client-related service and hence does not "target" the German market (under German law, own account trading

avoidance of doubt, we do not express any opinion in respect of activities Relevant Clearing Members may perform in addition to strictly providing clearing services under the Opinion Documents in particular any payment services.

Contractual agreements violating statutory law are generally null and void under German law only if they are in breach of prohibition provisions which apply to both parties (mutual prohibitions, *beiderseitige Verbotsgesetze*). [5] The provisions of the KWG prohibiting the conduct of banking business for unregulated entities are generally not seen as such mutual prohibitions within the meaning of section 134 BGB.[6] However, as a general principle, courts could find an agreement to be invalid if both of the parties knew about the licence requirements and acted together willingly breaching the law.[7]

Where one or both of the parties violate a licence requirement under the KWG by entering into an agreement, the respective agreements may either have to be terminated in accordance with their terms upon instruction of the German Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht*, "**BaFin**") or may be unwound by administrative order of the BaFin if it takes action against an entity for breach of German licensing

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(*Eigengeschäft*) means the purchase and sale of financial instruments for own account which is not qualified as dealing on own account, i.e., which is lacking of a "service element" and is not related to a (potential) client transaction). The Own Account Exemption does however not extend to own account trading via direct electronic access to a German trading venue, which continues to be a licensable activity.

5 German Federal Court of Justice (*Bundesgerichtshof*, "**BGH**") NJW 2000, 1186, 1187; Higher Administrative Court (*Verwaltungsgerichtshof*, "**VGH**") Kassel WM 2009, 1889, 1893; *Körner*, ZHR 131, 127, 135; *K.P. Berger,* in: Münchener Kommentar BGB, 8th ed. (2019), § 488 BGB no. 96; *Ellenberger,* in: Palandt, BGB, 80th ed. (2021), § 134 BGB no. 8.

6 Any individual person engaging in providing financial services without a licence commits a criminal offence and will be punished (i) in case of willful misconduct by a term of imprisonment of up to five years or (ii) in case of acting negligently by a term of imprisonment of up to three years or, alternatively in both cases by a monetary fine. In addition to the criminal sanctions for individuals, the German law also provides for a possibility to impose sanctions upon a legal entity. Pursuant to the German Act on Administrative Offences (*Ordnungswidrigkeitengesetz*) a legal entity may be punished by an administrative fine amounting up to EUR 5 million for negligent acts, EUR 10 million for willful misconduct or even higher if the economic benefit of the breach of law exceeds the maximum amount of the monetary fine. Furthermore, a court may order the forfeiture (*Einziehung*) of the gross proceeds (*Bruttoertrag*) of the respective entity without expenses to be deducted, i.e. an unlimited amount of the proceeds made in connection with the unlicensed activity may have to be paid into court and will be distributed to charity.

7 BGH MDR 1990, 416.

requirements.[8] An agreement must usually be unwound so that the parties are put into the position they were in when they initially entered into the agreement. If both of the parties acted together willingly breaching the law, the counterparty would likely not be able to claim damages from the entity which breached the licence requirements.

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

In relation to a central counterparty ("**CCP**") established in the European Union ("**EU**"), Article 14 para 2 EMIR in connection with Article 17 EMIR provides that once authorisation to provide clearing services has been granted by the competent authority in the member state of the EU ("**EU member state**") where it is established, such authorisation will be effective for the entire territory of the EU.

Pursuant to Article 25 para 1 EMIR, a CCP established in a third country may provide clearing services to clearing members or trading venues established in the EU if that CCP is recognised by ESMA. Following the notification by the United Kingdom of its intention to withdraw from the Union pursuant to Article 50 of the Treaty on European Union and the conclusion of the Withdrawal Agreement between the European Union and the United Kingdom on 17 October 2019, the United Kingdom became a third country on 1 February 2020 and, as a result of the transition period agreed in the Withdrawal Agreement, European Union law ceased to apply to and in the United Kingdom on 31 December 2020.

According to the European Commission's Implementing Decision (EU) 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, in accordance with Regulation (EU) No 648/2012 of the European Parliament and of the

[8] The legal basis for such an administrative order would be section 37 KWG. See further VGH Kassel WM 2009, 1889, 1893 and German Federal Administrative Court (*Bundesverwaltungsgericht,* "**BVerwG**") BKR 2011, 208, 211.

Council ("**Commission Equivalence Decision**"),[9] for the purposes of Article 25 EMIR, the legal and supervisory arrangements of the United Kingdom applicable to central counterparties already established and authorised in the United Kingdom, such as LCH, shall be considered to be equivalent to the requirements laid down in EMIR. On this basis, ESMA has announced on 28 September 2020 in line with the Commission Equivalence Decision that LCH is recognised as a third country CCP under Chapter 4 of Title III of EMIR ("**ESMA Recognition Decision**").[10] In line with the Commission Equivalence Decision, the ESMA Recognition Decision will only take effect on the day following the end of the transition period and continue to apply while the Commission Equivalence Decision remains in force (i.e. until 30 June 2022).

Special provisions on the supervision of CCPs pursuant to sections 53e *et seqq*. KWG and special resolution provisions pursuant to sections 152a *et seqq*. SAG apply to CCPs established in Germany only and would therefore not be relevant to LCH.

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

There are no regulatory filings which need to be made by a Relevant Clearing Member upon the entry into of the Clearing Membership Agreement.

To the extent German conflict of law provisions refer to English law, only applicable requirements under English law would need to be complied with as under German law there are no further filings, notifications or recordings or other formalities required in order for the Relevant Clearing Member to validly create a first priority perfected security interest under the Deed of Charge. Please see, however, paragraph 3.2.2 as to the effectiveness of the Deed of Charge in the context of Insolvency Proceedings below.

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9 OJ EU L 306 of 21 September 2020, p. 1.

10 https://www.esma.europa.eu/press-news/esma-news/esma-recognise-three-uk-ccps-1-january-2021

3.1.4 *Would the courts of the Relevant Jurisdiction uphold the contractual choice of law and jurisdiction set out in Regulation 51*?

(a) Choice of law

In court proceedings taken in Germany for the enforcement of the obligations of an obligor under any Opinion Document, the choice of English law under Regulation 51(a) of the General Regulations would be recognised, subject in each case to the provisions of the Rome I Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations ("**Rome I**")[11] and, where it concerns non-contractual obligations arising out of such Opinion Document, subject in each case to the provisions of the Regulation (EC) No 864/2007 of the European Parliament and of the Council of 11 July 2007 on the law applicable to non-contractual obligations ("**Rome II**").[12]

Where property rights (*dingliche Rechte*) are created in respect of contractual claims, a choice of law can be validly made in accordance with Article 14 Rome I. Mandatory provisions of the German Introductory Act to the Civil Code (*Einführungsgesetz zum Bürgerlichen Gesetzbuch*, "**EGBGB**") apply in respect of the conflict of property laws in respect of the creation of rights over moveables (*bewegliche Sachen*). Whether an object (*Gegenstand*) is a moveable has, under German conflict of laws provisions, to be determined in accordance with the law of the jurisdiction in which such object is located (*lex rei sitae*).

(b) Choice of jurisdiction

Pursuant to Regulation 51(c) of the General Regulations, LCH and every Relevant Clearing Member irrevocably agrees for the benefit of LCH that the courts of England shall have exclusive jurisdiction to hear and determine any claim or matter arising from or in relation to any Contract or in relation to the General Regulations which does not fall to be referred to arbitration under Regulation 51(b) of the General

[11] OJ EU No L 177 of 4 July 2008, p. 6.

[12] OJ EU No L 199 of 31 July 2007, p. 40.

Regulations, save that the submission to the exclusive jurisdiction of the English courts shall not limit the right of LCH to take proceedings in any other court of competent jurisdiction.

Since the United Kingdom has left the European Union:

(i) Regulation (EU) No 1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and enforcement of judgments in civil and commercial matters (recast) ("**Brussels I Regulation (Recast)**")[13], which only applies where the parties choose the jurisdiction of a Member State, is no longer applicable; and

(ii) from a German law perspective the effectiveness of a choice of forum clause will be subject to the governing law of the contract,[14] being English law[15] in the case of the Rulebook (on which we do not opine).

However, the choice of jurisdiction contained in Regulation 51(c) of the General Regulations will not be recognised by German courts to the extent a dispute is effectively referred to arbitration under Regulation 51(b) of the General Regulations if such Regulation prevails.

(c) Recognition of and defence based on arbitration agreement

Subject to the German Code of Civil Procedure (*Zivilprozessordnung*, "**ZPO**"), the arbitration agreement contained in Regulation 51(b) of the General Regulations – which refers to Regulation 33 of the General Regulations – would be recognised by the German courts. Accordingly, subject to the preconditions of sections 1025 *et seq.* ZPO having been met, the arbitration agreement may be raised as a procedural defense under section 1032 ZPO against any civil law action (other than preliminary proceedings (*einstweiliger Rechtsschutz*)) brought before a

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13 OJ EU No L351 of 20 December 2012, p.1.

14 *Gottwald*, in: Münchener Kommentar ZPO, 5th ed. (2017), Article 25 EUGVVO no. 3.

15 On 28 December 2019 the UK deposited a certificate of accession to the Hague Convention on Choice of Court Agreements 2005. The Hague Convention only applies in case both parties submitted to an exclusive jurisdiction clause. However, we do not consider the Hague Convention to be applicable in the case at hand as pursuant to Regulation 51(c) of the General Regulations LCH's right to take proceedings in any other court of competent jurisdiction is not limited.

German court. In line with section 1031 ZPO, it is permissible to arrange for arbitration in a contract which is signed by the parties (or concluded in letters, telefax copies, telegrams, or other forms of transmitting messages exchanged by the parties that ensure proof of the agreement) by referring in this contract to another (unsigned) document like the Rulebook that contains an arbitration clause if the reference is made such that this arbitration clause is incorporated into the contract. We do not opine on whether or not the Contracts contain effective references to the Rulebook.

It is not entirely clear whether the arbitration agreement contained in the Rulebook applies to the Clearing Membership Agreement. It is unclear if "Contract" in the meaning of Regulation 51(b) of the General Regulations includes the basic contract "Clearing Membership Agreement" or only the contracts entered into on the basis of the Rulebook. German courts generally demand that there must be a clear and non-ambiguous choice for arbitration. In the absence of such choice, an arbitration agreement would not be recognised by a German court. Since the Clearing Membership Agreement contains a special choice of jurisdiction (see section 13.1) and since the Clearing Membership Agreement does not refer to arbitration as a method for dispute settlement, a German court would most likely find that section 13.1 of the Clearing Membership Agreement prevails over the general rules under Regulation 51 of the General Regulations.

3.1.5 *Will the courts uphold the judgement of the English courts or an English arbitration award*?

(a) English court judgements

Since the United Kingdom is no longer a member of the European Union German courts will not recognise and enforce foreign judgments from the United Kingdom if:

(i) under German law,[16] the courts of the state in which the judgement was rendered did not have jurisdiction (section 328 para 1 no. 1 ZPO);

[16] We assume that the recognition and enforcement of an English judgement in Germany will be governed by the ZPO. However, it cannot be excluded that the 1968 Brussels Convention on jurisdiction and the

(ii) the defendant was not served the document initiating the foreign proceedings properly or timely enough for him to defend himself and relies on the fact that he did not make a general appearance in the foreign court (section 328 para 1 no. 2 ZPO);

(iii) the foreign judgment is irreconcilable with a German judgment or an earlier foreign judgment that would have to be enforced in Germany or the proceedings leading to the foreign judgment are irreconcilable with earlier pending proceedings in Germany (section 328 para 1 no. 3 ZPO);

(iv) the enforcement of the foreign judgment would lead to a result that would clearly be irreconcilable with fundamental principles of German law, in particular if the enforcement were to violate basic rights under the German Constitution (section 328 para 1 no. 4 ZPO); and

(v) reciprocity for the enforcement of judgments does not exist (section 328 para 1 no. 5 ZPO), except where the judgement concerns a non-pecuniary claim (*nichtvermögensrechtlicher Anspruch*) and under German law German courts did not have jurisdiction (section 328 para 2 ZPO).

(b) English arbitral award

An English arbitral award will be recognised and enforced by a German court subject to, and in accordance with the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 10 June 1958 ("**New York Convention**"), which has been ratified by

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enforcement of judgments in civil and commercial matters ("**Brussels Convention**") or the Convention between the United Kingdom and the Federal Republic of Germany for the mutual recognition and enforcement of judgments in civil and commercial matters of 14 July 1960 ("**Germany-UK Convention**") revive when the United Kingdom leaves the European Union without an agreement. The Brussels Convention was superseded by the Brussels I Regulation and there are good reasons to assume that it was intended to be replaced permanently between the EU member states, not only for so long as any of them remained a member of the EU. The Germany-UK Convention was also superseded by the Brussels Convention and by the Brussels I Regulation. However, since its conclusion was bilateral and not related to membership in the EU or its predecessors, there are good reasons to assume that the parties intended for it to revive should any multilateral European legal instruments cease to apply. Irrespective of whether German courts will apply the Brussels Convention, the Germany-UK Convention or the ZPO, exequatur proceedings will in any event be required for the recognition and enforcement of a judgment rendered by the courts of England.

Germany and implemented into German statutory law (section 1061 ZPO).[17]

Accordingly, recognition and enforcement of the award may be refused in Germany, if any grounds for refusal of recognition and enforcement under the New York Convention apply.

An order for the enforcement (*Vollstreckbarerklärung*) of an English arbitral award on a civil matter will be issued by a German court provided that the requirements for recognition are met and provided further that the party interested in the enforcement has filed for enforcement of the arbitral award with the competent court in Germany in compliance with applicable legal requirements for such filings, including but not limited to, the submission of the relevant documentation.

3.1.6 *Are there any "public policy" considerations that the courts may take into account in determining matters related to choice of law and/or the enforcement of foreign judgements*?

Yes, "public policy" considerations are taken into account by German courts in determining matters related to choice of law. For details see paragraph 4.1 below.

In respect of public policy considerations in relation to the enforcement of foreign judgements, please see paragraph 3.1.5(a)(iv) above.

3.2 Insolvency, Security, Set-off and Netting

3.2.1 *Please opine on insolvency proceedings and pre-insolvency reorganisation, restructuring and/or resolution measures in respect of Relevant Clearing Members under the laws of Germany. 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 of the Default Rules? Are any other events or procedures not envisaged in Rule 3 of the Default Rules relevant*?

Under paragraph 3.2.1(a) to, and including, 3.2.1(d) we provide an overview of mandatory insolvency proceedings, provisional insolvency measures, pre-insolvency restructuring, regulatory, recovery and resolution and related

[17] Germany adhered to the New York Convention on 30 June 1961 (BGBl. II 1961 p. 122).

proceedings under German law and in each case their international scope of application. Our specific answers are given in paragraph 3.2.1(j).

(a) Insolvency Proceedings under German law

The only bankruptcy, composition, rehabilitation or other insolvency or reorganisation procedures to which a Relevant Clearing Member could be subject under the laws of this jurisdiction, and which are relevant for the purposes of this opinion, are the procedures laid down in the German Insolvency Code (*Insolvenzordnung*, "**InsO**"). The main insolvency procedures (*Hauptinsolvenzverfahren*) under the InsO are referred to as "**Insolvency Proceedings**".[18] A Party who is subject to Insolvency Proceedings is called an "**Insolvent Party**" and its counterparty is called the "**Solvent Party**". When using the term Insolvency Proceedings we do not refer to opening proceedings (*Eröffnungsverfahren*), in particular not to any provisional insolvency measures (*vorläufige Maßnahmen*) taken under sections 21 *et seq*. InsO ("**Provisional Insolvency Measures**") (in respect of which see paragraph 3.2.1(c)).

Generally, Insolvency Proceedings may be opened by the competent insolvency court (*Insolvenzgericht*) upon the filing of an application by the debtor itself or any creditor provided such creditor has a legal interest in the opening of Insolvency Proceedings and substantiates (*glaubhaft machen*) a reason for the opening of Insolvency Proceedings (sections 13 para 1 and 14 para 1 InsO) and provided further a reason for the opening of Insolvency Proceedings is existing. The InsO enumerates the following reasons for the opening of Insolvency Proceedings:

(i) Illiquidity (*Zahlungsunfähigkeit*) is defined as the debtor's inability to settle its payment obligations when due (section 17 para 1 InsO). This is generally indicated if the debtor has ceased to make payments (*Zahlungseinstellung*)

[18] As a matter of principle, the InsO does not provide for group insolvency proceedings, i.e. each insolvent party being part of a group of companies would be subject to separate proceedings which may be spread throughout Germany (depending, as a general rule, on the relevant registered seat of the debtor) and involve different Insolvency Administrators. However, an insolvent debtor being part of a group of companies in Germany may request the insolvency court to declare itself competent in respect of any subsequent proceedings of any member of the group in Germany. In the absence of any conflicts of interest, it may be possible for the same Insolvency Administrator (as defined below) to be appointed for all group companies. In addition, the InsO also provides for rules governing the cooperation between insolvency courts and Insolvency Administrators.

(section 17 para 2 sentence 2 InsO). Illiquidity does not exist if there is only a temporary delay in payments (*Zahlungsstockung*), which according to the BGH, means the debtor's inability to make payments does not last for more than three weeks and then the debtor's gap in liquidity will be closed by expected payments, newly provided financing by other parties or the proceeds from the liquidation of assets.[19]

(ii) Impending illiquidity (*drohende Zahlungsunfähigkeit*) means that the debtor will not be able to fulfil existing payment obligations when they become due (section 18 para 1 InsO). Since the assessment whether there is an impending illiquidity is based on a prognosis, the insolvency court may require the debtor to submit a liquidity plan (*Liquiditätsplan*). An application to open Insolvency Proceedings on the basis of an impending illiquidity may only be filed by the debtor itself.

(iii) Over-indebtedness (*Überschuldung*) exists if the debtor's assets no longer cover its liabilities unless the existence of the debtor as a going concern is more likely (*überwiegend wahrscheinlich*) under the given circumstances (section 19 para 2 InsO). Over-indebtedness only applies to legal entities (*juristische Personen*) or partnerships that do not have a natural person as personally liable partner (section 19 paras 1 and 3 InsO). Over-indebtedness is determined on the basis of an insolvency balance sheet test. Claims for the repayment of shareholder loans or equivalent claims are not considered as liabilities in this context, if the shareholder has subordinated its claim (section 19 para 2 sentence 2 InsO).

Illiquidity and over-indebtedness are mandatory insolvency filing reasons. The management of the debtor is obliged to file for insolvency without undue delay (*ohne schuldhaftes Zögern*) and within a maximum period of 21 days if illiquidity or over-indebtedness exists (section 15a

[19] BGH NZI 2005, 547. The BGH further held that, as a rule, a debtor is not illiquid if the debtor is able to fulfil its payment obligations when due, except for a marginal amount of up to 10% of the whole sum. The 10% threshold is, however, not a fixed limit which would automatically allow the conclusion that a debtor is illiquid if it is exceeded or that it is not illiquid where the threshold is not reached.

InsO). If the management fails to file for insolvency within that deadline, it risks personal civil and criminal liability.

With respect to Credit Institutions and Financial Services Institutions (Credit Institutions and Financial Services Institutions collectively, "**Institutions**") only the BaFin may file an application for the opening of Insolvency Proceedings (section 46b para 1 sentence 4 KWG). In respect of Institutions, BaFin may file an application for the opening of Insolvency Proceedings by reason of impending illiquidity only upon the Institution's approval (section 46b para 1 sentence 5 KWG). Where a legal requirement to file for the insolvency exists, Institutions need only to notify BaFin (section 46b para 1 sentence 2 KWG).

For purposes hereof, the opening of Insolvency Proceedings refers to the time of the issue of an opening order (*Eröffnungsbeschluss*) for the opening of main insolvency proceedings (*Hauptverfahren*) by the competent insolvency court.

In the opening order the insolvency court appoints an insolvency administrator (*Insolvenzverwalter*, "**Insolvency Administrator**"). Upon the opening of Insolvency Proceedings the insolvent Relevant Clearing Member's right to manage and transfer assets belonging to the insolvency estate is vested in the Insolvency Administrator (section 80 InsO). Any dispositions of the insolvent Relevant Clearing Member over its property made after the opening of Insolvency Proceedings are void unless the relevant insolvency court otherwise orders (section 81 para 1 InsO).[20] If a creditor of the insolvent debtor obtained a security in respect of assets that form part of the insolvent debtor's assets by means of foreclosure measures (*Zwangsvollstreckungsmaßnahmen*) up to one month prior to the opening of Insolvency Proceedings or after the opening of Insolvency Proceedings, such security is void (section 88 InsO). Pursuant to section 91 para 1 InsO, after the opening of Insolvency Proceedings rights in objects forming part of the insolvency estate cannot be acquired with legal effect even if such acquisition of rights is not based on the Insolvent Party's transfer or effected by way of execution.

[20] Please refer to paragraph 3.2.1(g) with respect to exemptions for Financial Collateral (as defined therein).

Where an insolvency court has, upon application of the insolvent Relevant Clearing Member, ordered the management of the insolvent Relevant Clearing Member to continue its activities in accordance with section 270 InsO (*Eigenverwaltung*, "**Self Administration Proceedings**"), numerous rights of the Insolvency Administrator are exercised by the creditors' trustee (*Sachwalter*) (including any challenge in insolvency rights under sections 129 *et seq.* InsO as referred to in paragraph 3.2.4(a) below, see section 280 InsO). The insolvent Relevant Clearing Member may also exercise certain rights itself but in consultation with the creditors' trustee (including the Selection Right as defined in paragraph 3.2.3(c) below, see section 279 InsO). Self Administration Proceedings are not limited to a certain type of insolvent parties and are therefore generally available in respect of Institutions. An insolvency court may order Self Administration Proceedings when it releases an order for the opening of Insolvency Proceedings provided the insolvent Relevant Clearing Member has applied for Self Administration Proceedings and provided further there are no circumstances which would give rise to the assumption that Self Administration Proceedings would be detrimental to the insolvent Relevant Clearing Member's creditors (section 270 para 2 InsO).

Legal entities which are established under public law and subject to the supervision of a German Federal State (*Bundesland*) may be exempt from Insolvency Proceedings in Germany under the law of such Federal State (section 12 para 1 no. 2 InsO). Instead, special rules may apply or be enacted under public law to the winding-up of such entities and such special rules may have an impact on the enforceability of the Opinion Documents and the enforcement of any security interest or title transfer arrangements. Where a legal entity established under public law is not exempt from Insolvency Proceedings, it will generally be treated similar to entities established under private law. Legal entities incorporated under private law which are publicly owned are not exempt from Insolvency Proceedings.[21]

[21] *Sternal*, in: Heidelberger Kommentar InsO, 10th ed. (2020), § 12 InsO no. 7; *Gundlach/Frenzel/Schmidt*, NZI 2000, 561, 565.

(b) Territorial scope of application of Insolvency Proceedings

Insolvency Proceedings under German law apply universally to all assets of the insolvent Relevant Clearing Member, irrespective of the location of such assets (*Universalitätsprinzip*), subject to recognition under applicable foreign laws where such assets are from a German law perspective deemed to be located outside Germany.

Whether or not German insolvency courts have jurisdiction for opening Insolvency Proceedings over the assets of a Relevant Clearing Member depends on the rules governing the relevant proceedings. The international scope of application of Insolvency Proceedings and any Provisional Insolvency Proceedings and Regulatory Proceedings is governed by Regulation (EU) No 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast) ("**Recast EUIR**"),[22] Article 102 of the German Introductory Act to the InsO (*Einführungsgesetz zur Insolvenzordnung*, "**EGInsO**"), sections 3, 335 *et seq.* InsO and sections 46d to 46f KWG.

(i) Jurisdiction of German insolvency courts within the scope of application of the Recast EUIR

The Recast EUIR applies to insolvency proceedings as specified in Article 1 para 1, Annex A Recast EUIR. The Recast EUIR is not applicable, *inter alia*, to insolvency proceedings concerning insurance companies, credit institutions,[23] investment firms (*Wertpapierfirmen*)[24] and other firms, institutions and

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22 OJ EU No L 141 of 5 June 2015, p. 19. The Recast EUIR entered into force on 26 June 2015 and amends and replaces the Council Regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings ("**EUIR**") (OJ EU No L 160 of 30 June 2000, p. 1). The Recast EUIR applies to Insolvency Proceedings opened after 26 June 2017 while the EUIR continues to apply to relevant Insolvency Proceedings opened before that date.

23 In our view Article 1 para 2 Recast EUIR refers to CRR Credit Institutions (as defined below); see also *Kindler*, in: Münchener Kommentar BGB, 8th ed. (2021), Article 1 EuInsVO no. 15.

24 Pursuant to Article 1 para 2 lit (c) Recast EUIR, investment firms as defined in Article 4 para 1 no. 2 CRR and other firms, institutions and undertakings are outside the scope of application of the Recast EUIR insofar as they fall within the scope of the WUD (as amended). Article 4 para 1 no. 1 Directive 2014/65/EU of the European Parliament and the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (recast) ("**MiFID II**") (OJ EU No L 173 of 12 June 2014, p. 349) defines the term "investment firm" to include any legal person whose regular occupation or business is the provision of one or more investment services to third parties and/or the performance of one or more investment activities on a professional basis.

undertakings to the extent that they are covered by the Directive 2001/24/EC of 4 April 2001 on the Reorganisation and Winding-Up of Credit Institutions ("**WUD**")[25] and collective investment undertakings[26] (Article 1 para 2 Recast EUIR).[27]

The European Court of Justice ("**ECJ**") takes the view that the application of provisions of the EUIR and (consequently the Recast EUIR) does not generally depend on the existence of a cross-border link (*grenzüberschreitender Bezug*) to another EU member state (other than Denmark) unless a relevant provision of the EUIR and the Recast EUIR expressly requires such link. A cross-border link to a non-EU member state is sufficient.[28]

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[25] OJ EU No L 125 of 5 May 2001, p. 15. The WUD has been amended by Article 117 of Directive of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council (OJ EU No L 173 of 12 June 2014, p. 190) ("**BRRD**").

[26] In our view, for purposes of the Recast EUIR the term "collective investment undertaking" means undertakings for collective investment in transferable securities ("**UCITS**") as defined in the Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (recast) ("**UCITS Directive**") and alternative investment funds ("**AIFs**") as defined in Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 ("**AIFM Directive**") (see also Article 2 no. 2 Recast EUIR).

[27] The WUD is applicable to CRR Credit Institutions and their branches as defined under Article 4 para 1 no. 17 CRR set up in Member States other than those in which they have their head offices ("**EU Branches**"), subject to the conditions and exemptions laid down in Article 2 para 5 of Directive 2013/36/EU of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ EU No L 176 of 26 June 2013, p. 338, "**CRD IV**"). It also applies to the financial institutions, firms and parent undertakings falling within the scope of the BRRD. If a CRR Credit Institution has its head office outside the EU, the WUD only applies if such CRR Credit Institution has at least two EU Branches.

[28] Judgment of 16 January 2014, Case C-328/12, *Ralph Schmid v Lilly Hertel*, NJW 2014, 610, 611 *et seq*. See *Kindler*, in: Münchener Kommentar BGB, 8th ed. (2021), Article 1 EuInsVO no. 23; *Virgos/Schmit*, Report on the Convention on Insolvency Proceedings no. 11. See also the overview given by *Reinhart*, in: Münchener Kommentar InsO, 3rd ed. (2016), Article 1 EuInsVO 2000 nos. 15 *et seq*.

Within this scope of application, Article 3 para 1 Recast EUIR gives the courts of the EU member states (other than Denmark[29]) where the "centre of main interests" of a debtor is situated the ability to open main insolvency proceedings (as specified in Annex A of the Recast EUIR). In case of a legal entity, the place of the registered office is presumed to be the centre of its main interests in the absence of proof to the contrary (Article 3 para 1 Recast EUIR). These proceedings are generally governed by the law of the EU member state where such proceedings are opened. They are, with regard to other EU member states, international in scope being effective in all EU member states unless secondary proceedings are opened in another EU member state. The only main insolvency proceedings permitted under Annex A of the Recast EUIR under the laws of Germany would be Insolvency Proceedings.

If the "centre of main interests" of a debtor is in an EU member state (other than Denmark), under Article 3 para 2 Recast EUIR, the courts of another EU member state (other than Denmark) may open "territorial proceedings" or, after the opening of main proceedings, "secondary proceedings" in the event that such debtor possesses an "establishment" within the territory of such other EU member state. The applicable law of such territorial or secondary insolvency proceedings is the law of that other EU member state. However, territorial or secondary insolvency proceedings are limited in scope to the debtor's assets in that EU member state and will, thus, not extend beyond the EU member state where they are opened. Furthermore, under Article 3 para 3 Recast EUIR, secondary proceedings are limited to winding-up proceedings.

As a result of the implementation of the WUD, the opening of secondary or territorial insolvency proceedings is excluded in respect of CRR Institutions (section 46e KWG).[30] Insolvency

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[29] See *Tashiro,* in: Braun, InsO, 8th ed. (2020), before §§ 335-358 no. 13; *Kindler*, in: Münchener Kommentar BGB, 8th ed. (2021), Article 1 EuInsVO no. 22; *Virgos/Schmit*, Report on the Convention on Insolvency Proceedings no. 11.

[30] Section 46e KWG also applies to Resolution Orders (as defined below) and to any other resolution actions under sections 78 to 87 SAG (section 46e para 6 KWG).

Proceedings may only be opened by the competent authorities of the home state (*Herkunftsmitgliedsstaat*) of such CRR Institution.

(ii) Jurisdiction of German insolvency courts outside the scope of application of the Recast EUIR

Outside the scope of application of the Recast EUIR if an insolvent Relevant Clearing Member has its place of general jurisdiction in Germany, Insolvency Proceedings are opened in Germany with respect to the insolvent Relevant Clearing Member irrespective of whether or not the relevant authorities in any other jurisdiction have initiated proceedings in respect of a branch of the insolvent Relevant Clearing Member in such jurisdiction. In case of a legal entity, the place of general jurisdiction is the registered seat. If the centre of that legal entity's independent business activity is located elsewhere (e.g. if the management is located at a place other than the registered seat) such place determines the competent insolvency court (section 3 para 1 sentence 2 InsO). If the centre of an independent business activity of the insolvent Relevant Clearing Member is located outside Germany, German insolvency courts have no jurisdiction except for the opening of (separate) territorial or secondary Insolvency Proceedings (which are limited in their scope to the assets of the insolvent Relevant Clearing Member located in Germany).

Territorial Insolvency Proceedings can be commenced in Germany under section 354 para 1 InsO if the debtor has an establishment [31] in Germany. Where an insolvent Clearing Member has no establishment in Germany, a sufficient basis for separate proceedings in Germany under the InsO is also provided in respect of assets located or deemed to be located in Germany

[31] There is no definition of the term "establishment" (*Niederlassung*) in the InsO. Some legal authors (*Kindler*, in: Münchener Kommentar BGB, 8th ed. (2021), § 354 InsO no. 3; *Lüer/Knof*, in: Uhlenbruck, InsO, 15th ed. (2019), § 354 InsO no. 9) suggest to refer to the definition given in Article 2 no. 10 Recast EUIR while the LG Frankfurt am Main in its decision of 30 October 2012 (2-9 T 418/12) and others (*Reinhart*, in: Münchener Kommentar InsO, 4th ed. (2020), § 354 InsO no. 8) apply the definition which has been developed for purposes of section 21 ZPO), i.e. any branch office which is separate from the owner's seat and acts for a certain time in the owner's name and for its account independently, i.e. the branch office acts and enters into agreements upon its own decision (*Heinrich*, in: Musielak/Voit, ZPO, 17th ed. (2020), § 21 ZPO no. 2).

upon request of a creditor, if such creditor provides evidence for its "special interest" in the opening of German territorial proceedings due to the fact that it would have worse prospects (*erheblich schlechter stehen*) for the settlement of its debt in the non-German proceedings (section 354 para 2 InsO).[32] The recognition of foreign main insolvency proceedings under section 343 InsO does not exclude secondary proceedings. If territorial or secondary insolvency proceedings are opened in Germany, they take precedence over the non-German insolvency proceedings in relation to those assets of the insolvent Relevant Clearing Member which are situated in Germany. Such territorial or secondary insolvency proceedings and, thus, the applicability of German insolvency law are, however, limited in scope to the debtor's assets in Germany.

If the Relevant Clearing Member is not a CRR Institution, Insolvency Proceedings may be opened in Germany with respect to the Insolvent Party irrespective of whether or not the relevant authorities in any other jurisdiction have initiated proceedings in respect of a branch of the Insolvent Party in such jurisdiction. If a Relevant Clearing Member qualifies as a CRR Institution, Insolvency Proceedings may be opened in Germany if Germany is considered to be the home member state (section 46e para 1 KWG), which is the case if the main office (*Hauptniederlassung*) is located in Germany (section 1 para 4 KWG (which implements Article 2 WUD in connection with Article 4 para 1 no. 17 CRR)); the opening of secondary or territorial proceedings in other EU member states is excluded (section 46e para 2 KWG).

(iii) Location of payment claims

Under the Recast EUIR, payment claims are deemed to be located in the country in which the debtor of such claim has the centre of its main interests (Article 2 no. 9 viii) Recast EUIR). Therefore, if the centre of main interests of the Solvent Party is in another EU member state (other than Denmark), and there are

[32] Legal commentators suggest that this provision should be construed narrowly (see *Wenner*, in: Mohrbutter/Ringstmeier, Handbuch der Insolvenzverwaltung, 9th ed. (2015), Chapter 20 no. 129).

secondary proceedings under the Recast EUIR in respect of the Insolvent Party in that EU member state, then under the Recast EUIR the claims of such Insolvent Party against the Solvent Party would be deemed to be situated outside of Germany. The Insolvency Administrator would be required to defer to the jurisdiction of the insolvency administrator appointed in such other EU member state in relation to such claims (to the extent they have not been extinguished at the time of opening of Insolvency Proceedings).

Under the InsO, payment obligations are assets deemed to be located in Germany if they are payable by the debtor out of Germany to the Insolvent Party. Therefore, only such payment obligations are assets deemed to be located in Germany which are payable by the Solvent Party out of Germany and could provide a sufficient basis for separate Insolvency Proceedings in relation to such Insolvent Party.

(c) Provisional Insolvency Measures

Upon an application for the opening of Insolvency Proceedings but before the opening of Insolvency Proceedings a German insolvency court may appoint a provisional insolvency administrator (*vorläufiger Insolvenzverwalter*) and to release orders to protect the Insolvent Party's assets.

Provisional Insolvency Measures are limited to attachments (freezing injunctions) that prevent the Insolvent Party from disposing of its assets and thus jeopardising the purpose of Insolvency Proceedings. Such a freezing injunction may cover all the assets of the Insolvent Party or parts thereof. The insolvency court may impose a general prohibition of dispositions on the Insolvent Party (section 21 para 2 sentence 1 no. 2 InsO), order that the Insolvent Party's transfers of property require the consent of the provisional insolvency administrator (section 21 para 2 sentence 1 no. 2 InsO) or order a restriction (or temporary restriction) in certain measures of enforcement (*Zwangsvollstreckungsmaßnahmen*) against the Insolvent Party (section 21 para 2 sentence 1 no. 3 InsO). According to the BGH, Provisional Insolvency Measures pursuant to section 21 para 2 sentence 1 nos. 2 and 3 InsO do not exclude the permissibility of set-off since the provisions concerning insolvency set-

off pursuant to sections 94 through 96 InsO (see paragraph 3.2.3(i) below) are deemed as both comprehensive and exclusive.[33]

A provisional insolvency administrator does not have any powers which would entail a Selection Right, i.e. to choose whether or not to perform certain contracts in accordance with section 103 InsO (see paragraph 3.2.3(c)(i) below). As a Provisional Insolvency Measure, an insolvency court may particularly order that assets of an Insolvent Party which are subject to a security interest that entitles a creditor to separate satisfaction in accordance with section 166 InsO or entitles the creditor to a right for segregation must not be enforced nor must the creditor appropriate such assets (section 21 para 2 sentence 1 no. 5 InsO). However, pursuant to section 21 para 2 sentence 2 InsO, these restrictions do not apply to Financial Collateral.

(d) Pre-insolvency Restructuring

Implementing Directive (EU) 2019/1023 of the European Parliament and of the Council on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 of 20 June 2019 ("**Restructuring Directive**"),[34] the German Act on the Development of Restructuring and Insolvency Law (*Sanierungs- und Insolvenzrechtsfortentwicklungsgesetz*) introduced, *inter alia*, a pre-insolvency restructuring regime, which applies to all legal entities (*juristische Personen*) established under German law. While we believe that with respect to Institutions the Regulatory Proceedings or the Recovery and Resolution Proceedings would be more relevant, the restructuring regime under the Act on the Stabilisation and Restructuring of Businesses (*Unternehmensstabilisierungs- und Restrukturierungsgesetz*, "**StaRUG**") is generally applicable to Companies.

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[33] BGH NJW 2004, 3118, 3119; BGH ZIP 2005, 181.

[34] OJ EU No L 172 of 26 June 2019, p. 18.

For purposes hereof, the procedures described in this paragraph 3.2.1(d) are collectively referred to as "**Pre-Insolvency Restructuring Proceedings**".

The restructuring as envisaged by the Restructuring Directive and the StaRUG is intended to "… enable debtors in financial difficulties to continue business, in whole or in part, by changing the composition, conditions or structure of their assets and their liabilities or any other part of their capital structure — including by sales of assets or parts of the business or, where so provided under national law, the business as a whole — as well as by carrying out operational changes".[35] Pre-Insolvency Restructuring Proceedings involve the establishing of a restructuring plan, which may also affect obligations of the debtor and may also affect existing rights to the debtor's assets, unless these rights qualify as Financial Collateral or affect collateral which was provided to the operator of a System to secure its claims arising from the system or a central bank of a EU member state or the European Central Bank.

The opening of Pre-Insolvency Restructuring Proceedings or the use of the instruments under the StaRUG must not give in itself give rise to a reason for the termination of contractual relationships to which the debtor is a party, for acceleration of any obligations, for a right of the other party to refuse the performance incumbent upon it or to demand the adjustment or any other modification of the contractual terms (section 44 para 1 sentence 1 StaRUG). Pursuant to section 44 para 2 StaRUG any contractual provisions to the contrary are void. However, these restrictions do not apply to financial transactions covered by section 104 para 1 InsO (see paragraph 3.2.3(c) below), close-out netting arrangements under section 104 paras 3 and 4 InsO, Financial Collateral and transactions entered into a System subject to netting.

To the extent necessary to preserve the prospects of achieving the restructuring objective, the restructuring court is entitled, at the debtor's request, to order that measures of compulsory enforcement against the debtor are prohibited or temporarily discontinued (stay of execution; *Vollstreckungssperre*) and that rights to movable property which, would give right to segregation or separate satisfaction in the event of the opening of Insolvency Proceedings may not be enforced by the creditor

[35] See Recital 2 Restructuring Directive.

and that such assets may be used for the continuation of the debtor's business to the extent that they are of substantial importance (*erhebliche Bedeutung*) (stay of realisation; *Verwertungssperre*) (stabilisation order; section 49 para 1 StaRUG). However, section 56 para 1 StaRUG provides that the stabilisation order shall not affect the validity of dispositions (*Verfügungen*) over Financial Collateral and the validity of the set-off of claims and obligations from payment transfer orders, transfer orders between payment service providers or intermediaries or a transfer order of securities entered into a System. This shall also apply if such legal transaction of the debtor on the day of the stabilisation order is made or set off or Financial Collateral is created and the other party proves that it was neither aware nor should have been aware of the stabilisation order. If the other party is a system operator or a participant in the System, the date of the stablisation order is determined by reference to the business day within the meaning of section 1 para 16b KWG.[36]

Pursuant to section 56 para 2 StaRUG, transactions which could be subject to a close-out netting agreement within the meaning of section 104 paras 3 and 4 InsO as well as close-out netting arrangements shall remain unaffected by the stabilisation order and its effects. The claim resulting from the close-out netting may be subject to a stay of execution and, to the extent permissible under section 56 para 1 StaRUG also to a stay of realisation.

The aforementioned provisions entered into force on 1 January 2021 and there is rather limited guidance on the scope of these provisions so far.

(e) Regulatory Proceedings

LCH's rights under Rule 3 of the Default Rules may be affected by regulatory measures under the KWG.

Regulatory proceedings may be instituted and measures may be taken by BaFin or any other relevant competent authority, including the European Central Bank ("**ECB**") when acting in its capacity as

[36] Section 1 para 16b KWG refers to the business day of a system which comprises the usual business cycle of the system including day and night settlement.

supervisory authority for CRR Credit Institutions[37] or with respect to Credit Institutions or Financial Services Institutions licensed under the KWG (sections 45 to 46g KWG).

For purposes hereof, the procedures described in this paragraph 2.3.2 are collectively referred to as "**Regulatory Proceedings**".

(i) Federal Moratorium

In respect of Credit Institutions, if the German Federal Government (*Bundesregierung*) determines that a Relevant Clearing Member that is a Credit Institution is in economic difficulties which give rise to the assumption that the national economy, in particular payment transactions in general, are severely jeopardised, it may under section 46g KWG, among others, grant such Relevant Clearing Member a payment moratorium by the legal instrument of a regulation (*Rechts-verordnung*) and order that enforcement proceedings or Provisional Insolvency Measures against such Relevant Clearing Member or Insolvency Proceedings over its assets may not be opened for as long as the moratorium continues. It may also order that Credit Institutions must be closed for business with customers and may neither make nor accept payments or remittances with customers; such order may be restricted to a limited number of Credit Institutions or types of banking activities. We are not aware of any exemptions applicable to Systems in the event of a Federal Moratorium, however, the Federal Government is entitled to address potential consequences of such Federal Moratorium in such regulation (section 46g para 3 KWG).

[37] "**CRR Credit Institution**" means a credit institution as defined in Article 4 para 1 no. 1 of Regulation 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation 648/2012 (OJ EU No L 321 of 30 November 2013, p. 6, "**CRR**"), to be amended by Regulation (EU) 2019/2033 of the European Parliament and of the Council of 27 November 2019 on the prudential requirements of investment firms and amending Regulations (EU) No 1093/2010, (EU) No 575/2013, (EU) No 600/2014 and (EU) No 806/2014 ("**IFR**") (OJ EU No L 314 of 5 December 2019, p. 1) which will enter into force on 26 June 2021 (Article 66 IFR).

(ii) Regulatory measures

The relevant competent authority may take various regulatory measures in respect of a Relevant Clearing Member. Under section 45 KWG, the relevant competent authority may take measures for the reinforcement of such a Relevant Clearing Member's own funds and liquidity. In particular, the relevant competent authority can prohibit withdrawals by shareholders and the distribution of dividends, restrict or prohibit the granting of loans, order the Institution to take measures to reduce risks to the extent these risks result from certain types of transactions or products or the use of certain systems or order that the Relevant Clearing Member implements measures laid down in its recovery plan (*Sanierungsplan*).

Under section 45c KWG, the relevant competent authority may appoint a special representative (*Sonderbeauftragter*), to assume certain functions within an Institution (including management functions) and would confer the requisite powers on it.

Where the fulfilment of an Institution's obligations towards its creditors and, in particular, the security of the assets entrusted to it are jeopardised or if effective supervision is no longer possible, the relevant competent authority may take temporary measures under section 46 para 1 KWG, in particular:

(A) issue instructions for the management of the Institution's business;

(B) prohibit the acceptance of deposits or funds or securities from customers and the granting of loans;

(C) prohibit owners and managers from carrying out their activities or limit such activities;

(D) temporarily prohibit the disposition of assets or the making of any payments by such Institution (such prohibitions to dispose assets and to make payments, which are different from those under a Federal

Moratorium referred to in paragraph 3.2.1(e)(i) above, collectively "**Moratorium**");

(E) close the Relevant Clearing Member for ordinary business with customers; and

(F) unless an applicable deposit or customer protection scheme ensures full satisfaction of the customers, prohibit the Relevant Clearing Member from accepting payments except those made in respect of obligations owed to a Relevant Clearing Member.

It has been suggested in a court decision that the imposition of a Moratorium has the effect of a deferral (*Stundung*), i.e. extension of the due date.[38] Accordingly, set-off of obligations would not be permissible in circumstances where a Moratorium is imposed in respect of assets of and payments by a Relevant Clearing Member (as set-off may not be effected where the claim against which it is to be effected is not due).[39]

The BGH, however, has repealed the above-mentioned decision and confirmed that a Moratorium against an Institution such as a Relevant Clearing Member under section 46 para 1 sentence 2 no. 4 KWG would not result in a deferral.[40] Rather, the Moratorium creates a temporary obstacle to specific performance and, if imposed on such Relevant Clearing Member, would entitle such Relevant Clearing Member to refuse specific performance *vis-à-vis* its counterparty for as long as the

[38] See OLG Frankfurt ZInsO 2013, 388 *et seq*. The judgment has been given in respect of the former section 46a para 1 sentence 1 no. 1 KWG but the wording of section 46 para 1 sentence 2 no. 4 of the revised KWG is identical. This view has also been shared by the German legislator (BT-Drucksache 7/4631, p. 8 and BT-Drucksache 14/8017, p. 141).

[39] We do not believe that the acceleration of any obligations resulting from the operation of the Netting Provisions (as defined below) would be prohibited by a Moratorium but we are not aware of any court decisions dealing with this point.

[40] BGH WM 2013, 742, 748.

Moratorium continues to exist (based on an analogous application of section 275 para 1 BGB).[41]

While the BGH has left this question open, it has made *obiter* remarks indicating that a Moratorium does not prevent set-off. The BGH points out that the purpose of section 46 para 1 sentence 2 no 4 KWG to secure the assets of the Institution concerned (e.g. the Relevant Clearing Member) and prevent its insolvency would not prevent set-off. Even Provisional Insolvency Measures by an insolvency court and the opening of Insolvency Proceedings would generally not prevent set-off (see below, paragraph 3.2.3(i)) and section 46 para 1 sentence 2 no. 4 KWG is not intended to impose restrictions beyond the restrictions Insolvency Proceedings entail.[42] From a German law perspective these remarks are, in our view, convincing. The BGH did, however, not address the question whether a temporary obstacle for the performance of a claim would still prevent set-off against such claim given that German civil law allows for set-off only, if the claim against which set-off is to be effected can be performed (*Erfüllbarkeit der Hauptforderung*) (section 387 BGB). Whether and under which circumstances set-off in accordance with non-German law against claims of a Relevant Clearing Member which is subject to the Moratorium can be effected is, however, an open question.[43] The protection afforded to Systems and Financial Collateral under the InsO

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41 In dismissing that a Moratorium results in a deferral, the BGH argues that, as an administrative act (*Verwaltungsakt*) directed against the relevant Institution, the Moratorium would have to be made known to the Institution to become effective against it (section 43 para 1 sentence 1 of the German Act on Administrative Proceedings (*Verwaltungsverfahrensgesetz*), but would not become effective vis-à-vis its creditors as a notification (*Bekanntgabe*) vis-à-vis the creditors is not provided for under applicable laws (BGH WM 2013, 742, 747). Moreover, the counterparty's set-off right which is a protected property right under the German Constitution (*Grundgesetz*) can, according to the BGH, not be restricted without a clearly defined legal basis; see BGH WM 2013, 742, 744. *Helm/Keller*, BKR 2016, 59 argue that due to the fact a Moratorium is only declared vis-à-vis the relevant bank it will not entail any effects against other parties.

42 BGH WM 2013, 742, 747.

43 Prior to the BGH's decision, some authors argued that a ban of sales and payments would not exclude the possibility of set-off to the extent such possibility of set-off comes into existence upon or prior to the coming into force of the ban on payment and sales (*Binder*, Bankeninsolvenzen im Spannungsfeld zwischen Bankenaufsichts- und Insolvenzrecht (2005), p. 313); see also *Lindemann*, in: Boos/Fischer/Schulte-Mattler, KWG, 5th ed. (2016), § 46 no. 106.

applies *mutatis mutandis* to every Moratorium (section 46 para 2 sentence 7 KWG).

Following the institution of a Resolution Order, measures under sections 46 and 46g KWG may only be instituted upon the approval by the Resolution Authority (section 82 para 5 SAG).[44]

(e) Recovery and Resolution Proceedings

The rights of LCH under Rule 3 of the Default Rules may be affected by recovery and resolution measures under the German Recovery and Resolution Act (*Sanierungs- und Abwicklungsgesetz*, "**SAG**")[45] and Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010 ("**SRMR**").[46] The rights may be protected from the application of certain of these measures by virtue of the special rules applicable to Financial Collateral (described in paragraph 3.2.1(g) below) and Systems (described in paragraph 3.2.1(h) below).

For the purposes hereof, the procedures in this paragraph are collectively referred to as "**Recovery and Resolution Proceedings**". Recovery and Resolution Proceedings may be instituted and measures may be taken by the competent resolution authority ("**Resolution Authority**") with respect to CRR Credit Institutions, directly supervised by the ECB under

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44 See paragraph 3.2.1(e)(ii)(F).

45 The SAG transposes Directive of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council ("**BRRD**") (OJ EU No L 173 of 12 June 2014, p. 190) into German law. The BRRD was amended by Directive (EU) 2019/879 of 20 May 2019 amending Directive 2014/59/EU as regards the loss-absorbing and recapitalisation capacity of credit institutions and investment firms and Directive 98/26/EC (OJ EU No L 150 of 7 June 2019, p. 296) ("**BRRD 2**").

46 OJ EU No L 225 of 30 July 2014, p. 1, as amended by Regulation (EU) No 2019/877 of 20 May 2019 amending Regulation (EU) No 806/2014 as regards the loss-absorbing and recapitalisation capacity of credit institutions and investment firms ("**SRMR 2**") (OJ EU No L 150 of 7 June 2019, p. 226).

the SRMR [47] and with respect to other CRR Credit Institutions, Resolution Investment Firms [48] and group companies [49] (CRR Credit Institutions and Resolution Investment Firms which may be subject to resolution collectively, "**Resolution Firms**") under the SAG, in order to avoid the insolvency of any such institution or company.[50]

If the Resolution Authority has already instituted a resolution order (*Abwicklungsanordnung*) under sections 136, 77 SAG ("**Resolution Order**"), then measures under section 46 and section 46g KWG may only be instituted upon approval by the Resolution Authority (section 82 para 5 SAG).

(i) Competent Resolution Authority

In Germany, BaFin is the competent national Resolution Authority (section 3 para 1 SAG).

Acting within the single resolution mechanism ("**SRM**"), the Single Resolution Board ("**SRB**") has assumed certain resolution tasks and may take certain resolution actions or require BaFin

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47 The Single Resolution Board ("**SRB**") acting within the single resolution mechanism ("**SRM**") exercises resolution powers in respect of certain institutions and companies which are currently subject to the resolution powers of the Resolution Authority if they are subject to direct prudential supervision by the ECB. The SRB and the SRM are established under the SRMR which has direct effect in Germany and supersedes the SAG where the SRMR and the SAG govern the same scenario (see section 1 SAG).

48 "**Resolution Investment Firms**" are CRR Investment Firms which need to have a minimum initial capital of EUR 730,000 as provided in section 33 para 1 sentence 1 no. 1 KWG. "**CRR Investment Firms**" are investment firms within the meaning of Article 4 para 1 no. 2 CRR and "**CRR Institutions**" are CRR Investment Firms and CRR Credit Institutions.

49 "**Group Company**" means a parent undertaking or a subsidiary of a group (of companies), section 2 para 3 no. 30 SAG. In our view it is not entirely clear which affiliates of CRR Credit Institutions and Resolution Investment Firms can become subject to resolution action. The powers of the Resolution Authority generally relate to CRR Credit Institutions and Resolution Investment Firms as well as their group companies. However, section 64 SAG specifies the conditions for resolution only for certain subsidiaries (other than CRR Credit Institutions and Resolution Investment Firms), but does not refer to all group companies (see also *Binder*, in: Binder/Glos/Riepe, Handbuch Bankenaufsichtsrecht, 2nd ed. (2020), § 18 no. 52; *Bornemann*, in: Beck/Samm/Kokemoor, KWG, 217. AL (as of December 2020), 13. Gruppendimensionale Abwicklungsplanung und Abwicklung no. 164; *Geier*, in: Jahn/Schmitt/Geier, Handbuch Bankensanierung und -abwicklung, 1st ed. (2016), section B.I. no. 92).

50 We do not opine on any proceedings etc. applicable on the basis of a consolidated supervision or as a consequence of supervision as financial conglomerate or similar provisions.

acting in the capacity as the competent national resolution authority to implement a resolution scheme designed by the SRB although practical experience on the cooperation between the authorities is still limited. Article 1 SRMR states that the uniform rules and the uniform procedure for the resolution of the entities referred to in Article 2 SRMR and established in the participating member states (such as Germany) are to be applied by the SRB. Article 2 SRMR refers to CRR Credit Institutions established in a participating member state, parent undertakings, including financial holding companies and mixed financial holding companies, established in a participating member state, if they are subject to consolidated supervision carried out by the ECB in accordance with Article 4 para 1 lit (g) of Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions ("**SSMR**")[51] and investment firms and financial institutions established in a participating member state, where they are covered by the consolidated supervision of the parent undertaking carried out by the ECB in accordance with Article 4 para 1 lit (g) SSMR (each an "**SSMR Institution**").

The SRB and the Resolution Authority are under a duty to cooperate and Article 7 para 2 SRMR clarifies that the SRB is responsible for drawing up the resolution plans and adopting all decisions relating to resolution for: (a) SSMR Institutions that are not part of a group and for groups: (i) which are considered to be significant in accordance with Article 6 para 4 SSMR or (ii) in relation to which the ECB has decided in accordance with Article 6 para 5 lit (b) SSMR to exercise directly all of the relevant powers; and (b) other cross-border groups. In relation to entities and groups other than those referred to in Article 7 para 2 SRMR the Resolution Authority is entitled to perform, and is responsible for, the resolution tasks enumerated in Article 7 para 3 SRMR.

Article 29 para 1 SRMR states that the national resolution authorities shall take the necessary action by taking the

[51] OJ EU No L 287 of 29 October 2013, p. 63.

necessary measures in accordance with Article 35 or 72 BRRD and by ensuring that the safeguards provided for in BRRD are complied with when implementing decisions under the SRM. Article 29 SRMR also clarifies that the national resolution authorities shall exercise their powers under national law transposing BRRD and in accordance with the conditions laid down in national law (see also section 1 paras 2 to 4 SAG). This means that to the extent BaFin is acting as the competent national resolution authority BaFin would exercise its powers under the SAG. Under Article 29 para 2 SRMR, where a national resolution authority has not applied or has not complied with a decision by the SRB pursuant to the SRMR or has applied it in a way which poses a threat to any of the resolution objectives under Article 14 SRMR or to the efficient implementation of the resolution scheme, the SRB may order an institution under resolution (a) in the event of an action pursuant to Article 18 SRMR, to transfer to another person specified rights, assets or liabilities of an SSMR Institution under resolution, (b) in the event of a resolution action pursuant to Article 18 SRMR, to require the conversion of any debt instruments which contain a contractual term for conversion in the circumstances provided for in Article 21 SRMR or (c) to adopt any other necessary action to comply with the decision in question.

Notwithstanding the provisions of Article 29 SRMR (and other relevant references throughout SRMR) and that both legal acts in principle provide for the same resolution tools (sale of business tool, bridge institution tool, asset separation tool and bail-in tool), the interaction between the SRMR and the SAG is, due to lack of practical experience, in our view not entirely clear. Therefore, to the extent a relevant entity is covered by the SRMR and subject to a resolution decision by the SRB affected entities and their creditors might need to not only review the consequences under the SAG following implementation of such decisions but also the requirements under the SRMR for making such decisions and to assess the potential application of powers under the SRMR (in particular, as the relevant provisions under the SRMR, the BRRD and the SAG are not identical and they also may be subject to review by different courts). We also note that pursuant to Article 5 para 1 SRMR, where the SRB performs

tasks and exercises powers, which, pursuant to BRRD, are to be performed or exercised by the competent national resolution authority, the SRB would, for the application of SRMR and BRRD, be considered to be the relevant national resolution authority or, in the event of cross-border group resolution, the relevant group-level resolution authority. We are not aware of any court decision or any further guidance by the SRB or BaFin on this topic. Section 1 SAG provides that as far as the SRMR is not applicable the SAG applies. In the following, when referring to the SAG, we describe the powers of BaFin under the SAG but, as mentioned, the SRB may require BaFin to take resolution action based on the SRMR and the SRB or BaFin may under certain circumstances be entitled to exercise similar powers under the SRMR.

(ii) Crisis prevention measures (*Krisenpräventionsmaßnahmen*)

(A) SRMR

Under the SRM, early intervention measures are limited to enabling the SRB to prepare for the resolution of an SRMR Institution or the group concerned, including a duty of ECB and the relevant national competent authority such as BaFin to share information with the SRB. Article 10a grants the SRB the power to prohibit certain distributions, in particular where an SRMR Institution is in a situation where it meets the combined buffer requirement when considered in addition to each of the requirements referred to in points (a), (b) and (c) of Article 141a para 1 CRD IV, but it fails to meet the combined buffer requirement when considered in addition to the minimum requirement for own funds and eligible liabilities referred to in Articles 12d and 12e SRMR. Article 13 para 3 SRMR empowers the SRB to require the SRMR Institution, or the parent undertaking, to contact potential purchasers in order to prepare for the resolution of the SRMR Institution, to require the relevant national resolution authority to draft a preliminary resolution scheme for the SRMR Institution or group concerned.

Under the SSM, ECB is empowered to carry out supervisory tasks in relation to recovery plans, and early intervention where a CRR Credit Institution or group in relation to which ECB is the consolidating supervisor, does not meet or is likely to breach the applicable prudential requirements, and, only in the cases explicitly stipulated by relevant European Union law for the national competent authorities, structural changes may be required from CRR Credit Institutions to prevent financial stress or failure, excluding any resolution powers (Article 4 para 1 lit (i) SSMR).

(B) SAG

The relevant crisis prevention measures (*Krisenpräventionsmaßnahmen*) to be instituted under the SAG are enumerated in section 2 para 3 no. 37 SAG referring to the following provisions:

Under section 16 SAG, ECB with respect to SSM Institutions and BaFin with respect to any other entity obliged to submit a recovery plan, are empowered to direct the removal of deficiencies or impediments for the recoverability in the recovery plan. This may include measures to reduce the risk profile, including the liquidity profile, to enable timely recapitalisation measures, to review the business strategy and organisational structure, to make changes to the refinancing strategy and to make changes to the governance structure.

Under section 59 SAG, the NRA is empowered to reduce or remove impediments to the resolvability of CRR Institutions, which includes measures to require the CRR Institution (i) to enter into or revise any intragroup financing agreements, (ii) to enter into any service agreements to cover the provision of critical functions, (iii) to limit its maximum individual and aggregate exposures, (iv) to impose specific or regular additional information requirements relevant for resolution

purposes, (v) to divest specific assets, (vi) to limit or cease specific existing or proposed business activities or distribution of new or existing products, (vii) to change the legal or operational structures of the CRR Institution to reduce complexity in order to ensure that critical functions may be legally and operationally separated from other functions through the application of the resolution tools, (viii) to set up a parent financial holding company in a member state or an EU parent financial holding company, (ix) to issue eligible liabilities to meet the minimum requirements for eligible liabilities or alternative measures and (x) where the CRR Institution is the subsidiary of a mixed-activity holding company, to require that the mixed-activity holding company set up a separate financial holding company to control the CRR Institution, if necessary in order to facilitate the resolution of the CRR Institution and to avoid the application of the resolution tools and powers having an adverse effect on the non-financial part of the group. Section 60 SAG extends these powers to groups where the NRA is the competent authority for resolving the relevant group.

In the event of a significant deterioration of the financial position of a CRR Institution the competent supervisory authority is entitled to enact early intervention measures under sections 36 to 38 SAG. BaFin or, as applicable, the ECB, can, *inter alia*, require the management (i) to update the recovery plan when the circumstances that led to the early intervention are different from the assumptions set out in the initial recovery plan and implement one or more of the arrangements or measures set out in the updated plan, (ii) to examine the situation, identify measures to overcome any problems identified and draw up an action programme to overcome those problems and a timetable for its implementation, (iii) to draw up a plan for negotiation on restructuring of debt with some or all of its creditors according to the recovery plan, where applicable, (iv) to require changes to the institution's business strategy or changes to the legal or

operational structures of the institution, (v) to provide the competent supervisory authorities and the NRA, including through on-site inspections, all the information necessary in order to update the resolution plan and prepare for the possible resolution of the institution and for valuation of the assets and liabilities of the institution, or (vi) to convene, or (if the management fails to comply with that requirement) convene directly, a meeting of shareholders of the institution, and in both cases set the agenda. The competent supervisory authority may also require the CRR Institution to remove or replace one or more members of the management or supervisory board if those persons are found unfit to perform their duties pursuant to the KWG. If the aforementioned measures are not sufficient to remedy the significant deterioration then the competent supervisory authority may replace one or all members of the management or supervisory board or temporarily appoint one or more administrator(s) who may also be entrusted with the management of the institution.

Pursuant to section 66a para 1 SAG, the Resolution Authority may order the suspension of all or individual payment or delivery obligations of a Resolution Firm or group company arising from contracts to which it is a party if (1) the Resolution Firm's or group company's continued existence as a going concern is at risk; (2) there are no immediately available private sector measures that could avert the threat to the Resolution Firm's or group company's continued existence as a going concern; (3) the order is necessary to prevent the further deterioration of the financial position of the Resolution Firm or group company; and (4) the order is necessary (i) to determine that the implementation of a resolution action is necessary and proportionate to achieve one or more resolution objectives and that this would not be the case to the same extent if the Resolution Firm were to be wound up under normal insolvency proceedings, (ii) to decide which resolution actions are appropriate, or (iii)

to ensure the effective application of one or more resolution tools.

The Resolution Authority may also order a stay pursuant to section 66a para 2 SAG if this is necessary for the implementation of a decision of the SRB or if the SRB has determined the existence of the prerequisites pursuant to section 66a para 1 SAG and has notified the resolution authority thereof. Payment and delivery obligations vis-à-vis Systems, system operators within the meaning of section 1 para 16a KWG, central counterparties within the meaning of section 1 para 31 KWG, central counterparties within the meaning of section 1 para 31 KWG authorised in the European Union pursuant to Article 14 EMIR, as well as third country central counterparties recognised by ESMA pursuant to Article 25 EMIR and central banks are exempt from such suspension (section 66a para 3 SAG).

Pursuant to section 66a para 7 SAG, in the event of a suspension, the Resolution Authority needs to take into account the potential impact of the suspension on the orderly functioning of the financial markets. Within the time period specified for the measure, the suspension also extends to the payment or delivery obligations of each party to the contracts affected by the suspension and a payment or delivery obligation that would have fallen due during the specified period shall fall due immediately after the expiry of that period.

If the Resolution Authority has ordered a suspension, sections 46 and 46g KWG apply to the Resolution Firm or group member affected by the suspension during the period of suspension only with the consent of the Resolution Authority. If the Resolution Authority orders the suspension, it may exercise its powers to restrict security interests in accordance with section 83 and to temporarily suspend termination rights in accordance with section 84 for the period of the suspension.

Crisis prevention measures also include the power to write down or convert relevant capital instruments (section 89 SAG). Relevant capital instruments are Additional Tier 1 instruments (*zusätzliches Kernkapital*) and Tier 2 instruments (*Ergänzungskapital*).

(iii) Resolution Order

If the conditions for resolution are met, the Resolution Authority can take any action in accordance with the SAG to achieve the resolution objectives including issuing Resolution Orders under sections 77 para 1 no. 1, 136 SAG and together with or independent from a Resolution Order any other action under sections 78 to 87 SAG.[52] A Resolution Order may involve the following resolution tools: write down or conversion of relevant capital instruments and eligible liabilities (sections 89, 65 para 4 SAG), the bail-in tool (section 90 SAG), the sale of business tool (section 107 para 1 no. 1 lit (a) SAG), the bridge institution tool (section 107 para 1 no. 1 lit (b) SAG) and the asset separation tool (section 107 para 1 no. 2 SAG).[53]

The Resolution Authority may also, *inter alia*, order the modification (including any suspension) of the due date of any debt instruments issued or other bail-inable liabilities (*bail-in-fähige Verbindlichkeiten*) incurred by a Resolution Firm and any group companies or of the amount of any interest payable or the date when such interest is payable (section 78 para 1 no. 3 SAG).

(iv) Conditions for resolution

(A) SRMR

Under Article 18 SRMR, the SRB is entitled to adopt a resolution scheme upon assessing that the following conditions are met: (i) the entity is failing or is likely to

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[52] As regards the resolution objectives please refer to section 67 SAG, as regards the general principles on resolution please refer to section 68 SAG and as regards to the various valuation procedures please refer to sections 69 to 76 SAG.

[53] While we use the original terms of the English version of the BRRD this does not imply that the BRRD has been implemented on a one-by-one basis into German law.

fail, (ii) having regard to timing and other relevant circumstances, there is no reasonable prospect that any alternative private sector measures, including measures by an institutional protection system, or supervisory action, including early intervention measures or the write-down or conversion of relevant capital instruments and eligible liabilities in accordance with Article 21 para 1 SRMR taken in respect of the entity, would prevent the failure of the entity within a reasonable timeframe and (iii) a resolution action is necessary in the public interest.

Whether or not an entity is deemed to be failing or to be likely to fail is assessed by the ECB (after consultation with the SRB) on the basis of whether (i) the entity infringes, or there are objective elements to support a determination that the institution will, in the near future, infringe the requirements for continuing authorisation in a way that would justify the withdrawal of the authorisation by the ECB, including but not limited to the fact that the institution has incurred or is likely to incur losses that will deplete all or a significant amount of its own funds, (ii) the assets of the entity are, or there are objective elements to support a determination that the assets of the entity will, in the near future, be less than its liabilities, (iii) the entity is, or there are objective elements to support a determination that the entity will, in the near future, be unable to pay its debts or other liabilities as they fall due or (iv) extraordinary public financial support is required except where, in order to remedy a serious disturbance in the economy of an EU member state and preserve financial stability, that extraordinary public financial support takes any of the following forms: (a) a state guarantee to back liquidity facilities provided by central banks in accordance with the central banks' conditions, (b) a state guarantee of newly issued liabilities or (c) an injection of own funds or purchase of capital instruments at prices and on terms that do not confer an advantage upon the entity, where neither the circumstances referred to in points (i) to (iii) above nor the circumstances for writing down or

converting relevant capital instruments and eligible liabilities are present at the time the public support is granted.

If these conditions are met, the SRB adopts a resolution scheme. The resolution scheme places the entity under resolution, determine the application of the resolution tools to the institution under resolution, in particular any exclusions from the application of the bail-in in accordance with Article 27 paras 5 and 14 SRMR and determines the use of the Single Resolution Fund to support the resolution action. The proposed resolution scheme is subject to review and approval by the EU Commission and the EU Council, as set out in Article 18 paras 7 to 10 SRMR.

The SRB may apply the following resolution tools to meet the resolution objectives specified in Article 14 SRMR, in accordance with the resolution principles specified in Article 15 SRMR: the sale of business tool, the bridge institution tool, the asset separation tool and the bail-in tool. They may be applied either individually or in any combination, except for the asset separation tool which may be applied only together with another resolution tool.

(B) SAG

The conditions for the resolution of Resolution Firms are met if the ongoing existence of such entities is endangered (*Bestandsgefährdung*), the implementation of a resolution action (*Abwicklungsmaßnahme*) to achieve one or more resolution objectives (*Abwicklungsziele*) is necessary and proportionate (*erforderlich und verhältnismäßig*), and the situation cannot be remedied through measures other than resolution action with the same certainty, also having regard to the time

available (section 62 para 1 sentence 1 SAG).[54] The ongoing existence of Resolution Firms is endangered if either (1) the Resolution Firm infringes or there are objective elements to support the view that the Resolution Firm will, in the near future, infringe the requirements for holding a licence under section 32 KWG in a way that would justify the withdrawal of the licence by the relevant competent authority, (2) the assets of the Resolution Firm are or there are objective elements to support the view that the assets of the Resolution Firm will, in the near future, be, less than its liabilities or (3) the Resolution Firm is, or there are objective elements to support the view that the institution will, in the near future, be, unable to pay its debts or other liabilities as they fall due unless there is a serious chance (*ernsthafte Aussicht*) that following the issuance of a state guarantee (*staatliche Garantie*) (as referred to in the next sentence) the Resolution Firm is in a position to meet its liabilities when they fall due); section 63 para 1 SAG. The ongoing existence of a Resolution Firm is deemed to be endangered if extraordinary financial support is granted from public sources except when, in order to remedy a serious disturbance of the economy and preserve financial stability, the extraordinary public financial support takes any of the following forms: (i) a state guarantee to back liquidity facilities provided by central banks according to the central banks' conditions; (ii) a state guarantee of newly issued liabilities; or (iii) an injection of own funds or purchase of capital instruments at prices and on terms that do not confer an advantage upon the institution (for further details and exemptions refer to section 63 para 2 SAG).[55]

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[54] Section 62 para 1 sentence 2 SAG does not require that any crisis prevention measures or any other appropriate measures under the KWG are instituted before a resolution action.

[55] Section 64 SAG provides that the conditions for the resolution of a financial institution as defined in Article 4 para 1 no. 26 CRR which is a subordinated undertaking of a parent undertaking subject to prudential supervision at a consolidated level are met if the conditions for the resolution of the parent undertaking pursuant to section 62 SAG are met. Pursuant to section 64 para 2 SAG, the resolution requirements in relation

(v) Bail-in powers

(A) SRMR

Under Article 27 SRMR the bail-in tool may be applied (i) to recapitalise an SRMR Institution to the extent sufficient to restore its ability to comply with the conditions for authorisation (to the extent that those conditions apply) and to continue to carry out the activities for which it is authorised and to sustain sufficient market confidence in the SRMR Institution[56] or (ii) to convert to equity or reduce the principal amount of claims or debt instruments that are transferred (a) to a bridge institution with a view to providing capital for that bridge institution; or (b) under the sale of business tool or the asset separation tool. Certain liabilities, whether they are governed by the law of a member state or of a third country, are not subject to write-down or conversion, including covered deposits.

The liabilities subject to bail-in are defined in Article 27 paras 3 to 5 SRMR. The scope of the bail-in tool does not prevent, where appropriate, the exercise of the bail-in

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to a financial holding company (as defined in Article 4 para 1 no. 20 CRR), a mixed financial holding company (as defined in Article 4 para 1 no. 21 CRR), a mixed activity holding company (as defined in Article 4 para 1 no. 22 CRR), a parent financial holding company in an EU member state (as defined in Article 4 para 1 no. 30 CRR), an EU parent financial holding company (as defined in Article 4 para 1 no. 31 CRR), a parent mixed financial holding company in an EU member state (as defined in Article 4 para 1 no. 32 CRR) or an EU parent mixed financial holding company (as defined in Article 4 para 1 no. 33 CRR) shall be deemed to exist if the conditions in section 62 para 1 SAG in relation to any of the aforementioned holding companies are fulfilled. By way of derogation from para 2, the Resolution Authority may also take resolution measures in respect of a holding company referred to in para 2 if (1) the requirements referred to in section 62 para 1 are met in relation to one subsidiary or several subsidiaries of that holding company, provided that the subsidiaries are Institutions which are not themselves resolution entities, (2) the assets and liabilities of the subsidiary or of the subsidiaries referred to in number 1 are of such a nature that their default would pose a threat to the resolution group as a whole, (3) a resolution action in respect of that holding company for the resolution of a subsidiary or subsidiaries as referred to in number 1 is necessary for the resolution of the resolution group as a whole, and (4) that holding company is a resolution entity (section 64 para 3 SAG).

[56] The bail-in tool may be applied for such purpose only if there is a reasonable prospect that the application of that tool, together with other relevant measures including measures implemented in accordance with the business reorganisation plan will, in addition to achieving relevant resolution objectives, restore the entity in question to financial soundness and long-term viability.

powers to any part of a secured liability (or a liability for which collateral has been pledged) that exceeds the value of the assets, pledge, lien or collateral against which it is secured or to any amount of a deposit that exceeds the coverage level provided for in Article 6 of Directive 2014/49/EU of 16 April 2014 on deposit guarantee schemes (recast).[57] Liabilities with a remaining maturity of less than seven days, owed to systems or operators of systems designated in accordance with the SFD or to their participants and arising from the participation in such a system, or to CCPs authorised in the Union pursuant to Article 14 EMIR and third-country CCPs recognised by ESMA pursuant to Article 25 EMIR.

When implementing any decisions under SRMR, the Resolution Authority needs to ensure that the safeguards provided for in BRRD (as implemented under the SAG) are complied with. The safeguards provided under Article 77 para 1 subpara 1 BRRD requires EU member states to ensure that there is appropriate protection for, *inter alia*, set-off and netting arrangements so as to prevent the transfer of some, but not all, of the rights and liabilities that are protected under a set-off arrangement or netting arrangement between the institution under resolution and another person and the modification or termination of rights and liabilities that are protected under such set-off arrangement or netting arrangement through the use of ancillary powers. Article 77 para 1 subpara 2 BRRD clarifies that such rights and liabilities are to be treated as protected under such an arrangement if the parties to the arrangement are entitled to set-off or net those rights and liabilities (please refer to paragraph 3.2.1(e)(vi)(B) below as regards the implementation of Article 77 para 1 BRRD through section 79 para 6 SAG).

We also note that Article 27 SRMR provides for an exemption for secured liabilities, but it does not provide

[57] OJ EU No L 173 of 12 June 2014, p. 149.

for an exemption similar to Article 49 BRRD (or section 93 SAG, as such section implemented Article 49 BRRD into German law).[58] Article 49 BRRD provides that only the relevant net settlement amount would be subject to bail-in. Article 12c para 6 subpara 1 SRMR provides for the purposes of determining the eligible liabilities for resolution entities that derivative liabilities shall be included in the total liabilities on the basis that full recognition is given to counterparty netting rights. However, the provisions of the SRMR potentially relevant to bail-in do not refer to netting. Since Article 12c SRMR addresses certain minimum requirements for eligible liabilities this could suggest that Article 12c para 6 subpara 1 SRMR contains a generally applicable principle, indicating that the SRMR is "netting-friendly", even though such minimum requirements are intended to create sufficient capacity for bail-in. Further, where the SRB collects data on banks' liabilities with the aim of collecting information for drawing up and implementing resolution plans (liability data reports), according to the relevant guidance thereon, [59] derivatives are usually required to be reported on a net value basis per contractual netting set taking into account prudential netting rules. While the foregoing relates specifically to derivatives and does not directly apply to the exercise of bail-in powers under Article 27 SRMR, we still believe

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[58] We are also not aware of any guidance to what extent the Resolution Authority is entitled to (independently) apply section 93 SAG (see paragraph 1.1.1(e)(v)(B) above for a summary of section 93 SAG) when implementing the SRB's decision under Article 29 SRMR. However, we understand that the relevant resolution scheme reflected in the SRB's decision will already identify the relevant eligible liabilities subject to bail-in, including their relevant amount, so there would be no room for the Resolution Authority to exercise discretion and determine the actual amount of the eligible liabilities when implementing such resolution scheme.

[59] Guidance on the Liability Data Report, available under https://srb.europa.eu/en/content/liability-data-report. The report also refers to secured finance which includes all financing arrangements that are subject to the provision of collateral, pledges or liens and gives as "[T]ypical examples … repurchase agreements." Given the definition we also believe that securities lending transactions are covered. In any event, the report stipulates that "… secured finance arrangements have to be reported by netting set…".

that the SRB, when exercising any discretion under Article 27 para 1 SRMR would recognise netting.

(B) SAG

With respect to the individual resolution tools, the bail-in tool (*Instrument der Gläubigerbeteiligung*) (section 90 SAG) empowers the Resolution Authority to either convert bail-inable liabilities (*bail-in-fähige Verbindlichkeiten*) of a Resolution Firm or group company into shares or other Common Equity Tier 1 (for purposes of Article 28 CRR) items or partially or fully write down or cancel eligible liabilities. Liabilities are eligible for bail-in unless relevant liabilities are covered by one of the exemptions in section 91 SAG or the Resolution Authority, exercising due discretion and having regard to the criteria in section 92 SAG, decides to exempt liabilities from the application of section 90 SAG in certain specified cases (see also section 2 para 3 no. 10a and 10b SAG).

With respect to derivatives in general (as defined in section 2 para 3 no. 11 SAG by reference to the definition of financial instruments under section 1 para 11 sentence 3 KWG) the bail-in tool may only be applied after or simultaneously with the "closing-out" (*Glattstellung*) of such derivatives (section 93 para 1 SAG). Hence, only the relevant net settlement amount would be subject to bail-in.[60]

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[60] 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 (see Recital 17 of Commission Delegated Regulation (EU) No 2016/1401 of 23 Mai 2016 supplementing Directive 2014/59/EU of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms with regard to regulatory technical standards for methodologies and principles on the valuation of liabilities arising from derivatives (OJ EU No L 228 of 23 August 2016, p. 7) ("**Delegated Regulation 2016/1401**"), providing 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 internal procedures and mechanisms governing the default of a clearing member ('CCP default procedures') implemented by CCPs in light of the requirements of […[EMIR]…] offer a reliable basis to determine the

Pursuant to section 93 para 2 SAG the Resolution Authority is empowered to terminate and close out derivatives transactions. If transactions are entered under an agreement qualifying as netting arrangement (*Saldierungsvereinbarung*) the Resolution Authority or an independent valuation expert is obliged to determine the net amount of the derivative transactions and to simultaneously or subsequently apply the bail-in tool to the net claim (section 93 para 3 SAG).

Pursuant to section 2 para 3 no. 43 SAG, "netting arrangement" means an arrangement under which a number of claims or obligations can be converted into a single net claim, including (1) arrangements under which, upon the occurrence of an enforcement event the obligations of the parties are accelerated so as to become immediately due or are terminated, and in either case are converted into or replaced by a single net claim (close-out netting arrangement), (2) set-offs based on a termination (close-out netting) as defined in Article 2 para 1 lit (n) of Directive 2002/47/EC of 6 June 2002[61] on financial collateral arrangements as amended by Directive 2009/44/EC [62] ("**Financial Collateral Directive**" or "**FCD**") and (3) netting (*Aufrechnung*) as defined in Article 2 lit (k) of the Directive 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 by Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and

value of the derivative liability arising across the netting set from the close-out, also in the context of bail-in in a resolution process".

61 OJ EU No L 168 of 27 June 2002, p. 43.

62 OJ EU No L 146 of 10 June 2009, p. 37.

Regulation (EU) No 236/2012 ("**Settlement Finality Directive**" or "**SFD**").[63]

We note that there is currently no guidance on the meaning of the definitions in section 2 para 3 no. 43 SAG and any restrictions the Resolution Authority might apply in construing these terms. Section 93 para 5 SAG extends the scope of section 93 paras 1 to 4 SAG also to obligations arising under financial transactions within the meaning of section 104 para 1 InsO which are included in a master agreement as defined in section 104 para 3 InsO. As the purpose of section 93 para 5 InsO is to extend the exemption to instruments which may not qualify as derivatives[64] we believe that when construing the term "netting arrangement" under sections 93 para 3, 2 para 3 no. 43 SAG such term does not need to be construed by reference to the definition of "master agreement" used in section 104 para 3 InsO. Such definition would only be relevant in the context of section 93 para 5 SAG, i.e. where the relevant liability potentially subject to bail-in does not qualify as derivative but may still qualify as financial transaction under section 104 para 1 sentence 2 InsO. We are not aware of any court decision on this question.[65]

The Netting Provisions (as defined below) provide for the termination of mutual obligations between LCH and a Relevant Clearing Member upon the occurrence of an Automatic Early Termination Event or the sending of a

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63 The SFD was amended by Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012 ("**CSDR**"). In the English language version, both Article 2 para 1 lit (n) of the FCD and Article 2 lit (k) of the SFD refer to "close-out netting" or "netting" while the German language version refers to set-off (*Aufrechnung*).

64 See BT-Drucksache 18/6091, p. 86.

65 Please refer to paragraph 3.2.3(c)(ii) as to how the BGH understands the term "netting agreement" (the decision was rendered on the basis of a version of section 104 InsO which is no longer applicable). The definition of "master agreement" under section 104 para 3 InsO refers to a master agreement or rules of a central counterparty, which provide that the transactions may, upon the occurrence of certain events, only be terminated in their entirety; see paragraph 3.2.3(d).

Default Notice and the calculation of a single claim to replace the mutual obligations (Rules 3, 6 and 8 of the Default Rules). The Netting Provisions would in our view qualify as a netting arrangement, as they provide for the conversion of various obligations of a Relevant Clearing Member *vis-à-vis* LCH. However, we understand that LCH has discretion to terminate certain but not all Contracts. If a court construes the term netting arrangement under section 2 para 3 no. 43 lit (a) SAG that only master agreements or rules of a central counterparty which provide for the termination of the entirety of all transactions qualify then such court would not recognise the Netting Provisions as a netting arrangement (see also paragraph 3.2.1(e)(vi)(B)). Based on our above analysis, we believe that the Netting Provisions would still qualify as a netting arrangement, and, as a result, the Resolution Authority would be prevented from applying write-off or conversion powers to individual claims under Contracts covered by the netting provision. Instead it would be entitled to close out the outstanding transactions, to calculate a net claim and to write off or convert such net claim pursuant to section 93 para 3 SAG. We note that Article 27 SRMR does not provide for an exemption similar to section 93 SAG (or Article 49 BRRD). It is therefore not entirely clear whether the SRB when exercising any discretion under Article 27 para 1 SRMR will recognise any netting or whether section 93 SAG can still be applied by BaFin when implementing the SRB's decision under Article 29 SRMR.

If the Netting Provisions do not qualify as a netting arrangement, they may qualify as a set-off agreement. There is no definition of "set-off arrangement" in the SAG. However, under Article 2 para 1 no 99 BRRD "set-off arrangement" means an arrangement under which two or more claims or obligations owed between the institution under resolution and a counterparty can be set off against each other. Based on this broad wording, the term "set-off arrangement" seems to cover any

agreement by which parties set off their liabilities.[66] The Netting Provisions would appear to contain sufficient elements of set-off to qualify as a set-off agreement. Therefore, even if the Netting Provisions do not qualify as a netting arrangement, they might qualify as a set-off agreement.[67]

Secured liabilities within the meaning of section 91 para 2 no. 2 SAG would not be subject to bail-in to the extent the secured liability is secured or covered by value of the secured collateral asset.[68] There is no definition of "secured liabilities" in the SAG. However, Article 2 para 1 no. 67 BRRD defines secured liabilities as liabilities where the right of the creditor to payment or other form of performance is secured by a charge, pledge or lien, or collateral arrangements including liabilities arising from repurchase transactions and other title transfer collateral arrangements.[69] In our view, the term "secured liabilities" under the SAG should be construed accordingly. In our view, the fact that in the context of derivatives generally

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66 However, the European Banking Authority ("**EBA**") has concluded that rules preventing a separation of rights and liabilities should be applied in a restrictive manner (see technical advice by the European Banking Authority on classes of arrangements to be protected in a partial property transfer of 14 August 2015 (http://www.eba.europa.eu/documents/10180/983359/EBA-Op-2015-15+Opinion+on+protected+arrangements.pdf)): "In any event, the protection should be limited to liabilities clearly identified in the set-off arrangement (at least by category). In addition, the delegated acts should specify precise criteria when such arrangements and liabilities qualify for this protection. Ideally the scope of the safeguard should be limited to certain qualifying arrangements and certain liabilities." Conversely, the EBA also notes that "qualifying arrangements could for example include only financial contracts as defined in point (100) of Article 2 para 1, and the protection apply only to them (this term would need to include options, futures, swaps, forward rate agreements and any other derivative contracts)". See also Article 3 para 2 of the Commission Delegated Regulation (EU) No 2017/867 of 7 February 2017 on classes of arrangements to be protected in a partial property transfer under Article 76 of the BRRD (OJ EU No L 131 of 20 May 2017, p. 15 to 19) for further limitations on which set-off arrangements are protected and covered by Article 76 para 2 lit (c) BRRD.

67 Regulation 10 (e) of the General Regulations contains a set-off right but see footnote 66 above with respect to a proposal for limiting the interpretation of "set-off arrangement" as the relevant liabilities may be subject to numerous generally applicable contractual or even statutory set-off rights.

68 Conversely, the bail-in tool might be applied to that part of the secured liability that exceeds the value of the security or cover; section 91 para 2 no. 2 SAG.

69 See also Article 6 Delegated Regulation 2016/1401.

margin is provided does not mean that derivatives in general qualify as secured liabilities. As collateral is already included in the calculation of the relevant net settlement amount available for bail-in we do not believe that to the extent section 93 SAG applies, Contracts need to be protected from bail-in under the exemption for secured liabilities unless the net settlement amount as such would be protected by such (additional) collateral.[70] We therefore understand and construe section 91 para 2 no. 2 SAG that such exemption would only be available for derivatives if the relevant net settlement amount resulting from the application of close-out netting were to be secured separately.

The exemption under section 91 para 2 no. 2 SAG does not apply to collateral which has been granted under transfer of title arrangements and is therefore enforced by way of close-out netting by inclusion in the calculation of the net claim.[71] We are not aware of any court decisions on this question.

Liabilities with a residual term of less than seven days to Systems, system operators within the meaning of section 1 paragraph 16a KWG, if these liabilities result from participating in the system or to CCPs established in the European Union pursuant to Article 14 EMIR and CCPs from third countries authorised by ESMA in accordance with Article 25 EMIR, are also exempted (section 91 para 2 no 6 SAG).

(vi) Powers to transfer assets and liabilities

(A) SRMR

The sale of business tool under Article 24 SRMR involves the transfer to a purchaser that is not a bridge

[70] Please refer to Article 5 Delegated Regulation 2016/1401, stating that collateral is included in the calculation of the early termination amount.

[71] In this respect, see Rule 8(c) and (d) of the Default Rules.

institution of instruments of ownership issued by an institution under resolution or all or any assets, rights or liabilities of an institution under resolution. Under the bridge institution tool, instruments of ownership issued by one or more institutions under resolution or all or any assets, rights or liabilities of one or more institutions under resolution are transferred to a bridge institution (Article 25 SRMR). The asset separation tool under Article 26 SRMR consists of the transfer of assets, rights or liabilities of an institution under resolution or a bridge institution to one or more asset management vehicles. As regards any applicable safeguards please refer to the next paragraph.

(B) SAG

Shares or all or any assets including the liabilities of a Resolution Firm or group company in resolution may be transferred to a third party under the sale of business tool (section 107 para 1 no. 1 lit (a) SAG) or to a bridge institution[72] under the bridge institution tool (section 107 para 1 no. 1 lit (b) SAG) if the Resolution Authority determines that the conditions for resolution of the Resolution Firm or group company are met.

Under the asset separation tool (section 107 para 1 no. 2 SAG) all or any assets including the liabilities of the Resolution Firm or group company in resolution may be transferred to an asset management company. Secured assets and liabilities may not be separated from the relevant collateral assets serving as security as such assets or liabilities may only be transferred if they are transferred together with any relevant collateral assets and all collateral assets may only be transferred together with the relevant assets or liabilities which are secured

[72] "Bridge institution" (*Brückeninstitut*) means a legal entity which (1) is entirely held by the Resolution Authority or another public authority, (2) is controlled by the Resolution Authority on the basis of corporate law, contract law or public law powers to exercise influence and (3) has been established as a bridge institution for purposes of section 107 SAG (section 128 SAG).

by such collateral assets; section 110 para 1 SAG. This prohibition of partial transfers is extended by section 110 para 3 SAG to collateral assets securing liabilities included in a System, to netting arrangements (*Saldierungsvereinbarungen*) and set-off arrangements (*Aufrechnungsvereinbarungen*).

As mentioned, based on the definition of netting arrangements in the SAG (above, paragraph 3.2.1(e)(v)(B)), we believe that the Netting Provisions would qualify as a netting arrangement. If the Netting Provisions do not qualify as a netting arrangement, they may qualify as a set-off agreement. If so, a partial transfer of transactions subject to them should in our view not be permissible but there is currently no clarity on the meaning of these terms and we are not aware of any court decision.

As long as the conditions to resolution are fulfilled, the asset transfer tools can be used multiple times and each transfer is valid (and the transfer of title is actually effected) upon the publication of the relevant Resolution Order (sections 114, 136 SAG).

Separately, section 79 para 2 SAG empowers the Resolution Authority to modify or cancel (*ändern oder beseitigen*) the rights of third parties in respect of the Resolution Firm's assets. Section 79 para 5 SAG further empowers the Resolution Authority, in respect of a contract to which the Resolution Firm or group company is a party, (i) to amend some or all provisions, (ii) to refuse performance or (iii) to replace the Resolution Firm or group company with a transferee entity as the counterparty. The power pursuant to section 79 para 5 SAG must not be exercised (i) in respect of Financial Collateral as well as netting and set-off arrangements, (ii) so as to result in a cancellation of transfer orders for purposes of Article 5 SFD and or (iii) so as to affect the validity of transfer orders or set-offs in accordance with Articles 3 and 5 SFD, credit entries, securities or credit

facilities for purposes of Article 4 SFD or rights *in rem* for purposes of Article 9 SFD (section 79 paras 6 and 7 SAG).

The powers under section 79 SAG are generally available to the Resolution Authority and may be ordered if required to effectively implement Resolutions Orders or achieve any resolution goals. Given that the collateral arrangements under the Rulebook should qualify as Financial Collateral (below, paragraph 3.2.1(g)) and that the Netting Provisions should qualify as a set-off agreement (whereas it is not entirely clear whether it qualifies as a netting arrangement, see paragraph 3.2.1(e)(v)(B)) and in light of the exemptions in relation to Financial Collateral and set-off agreements, the application of section 79 para 5 SAG should be excluded in respect of Relevant Clearing Members rights under the Rulebook.

(vii) Powers to temporarily suspend the enforcement of rights, claims and security interests and exemptions

(A) SAG

The Resolution Authority is entitled under section 82 para 1 SAG to suspend any payment or delivery obligations under any contract to which a Resolution Firm or group company under resolution is a party from the publication of a notice of the suspension in accordance with section 137 SAG until the end of the business day following such publication. Such suspension may also affect payment and delivery obligations arising under a Contract. Any suspension under section 82 para 1 SAG does not apply to payment and delivery obligations owed to Systems within the meaning of section 1 para 16 KWG, system operators within the meaning of section 1 para 16a KWG, central counterparties within the meaning of section 1 para 31 KWG authorised in the European Union pursuant to Article 14 EMIR, as well as third country central

counterparties recognised by ESMA pursuant to Article 25 EMIR and central banks.[73] With respect to the qualification of the LCH as a System please see paragraph 3.2.1(h). Given the clear wording, this exemption should only apply to liabilities owed by Relevant Clearing Members to LCH but not the liabilities LCH owes to its Relevant Clearing Members. Whether claims that Relevant Clearing Members have against LCH can be temporarily suspended is not a question of German law as LCH is not subject to the SAG.

A payment or delivery obligation which would have been due during the suspension period becomes due immediately upon expiry of the suspension period. If the payment or delivery obligations of an institution under resolution under a contract are suspended, the payment or delivery obligations of such institution under resolution's counterparties under that contract are suspended for the same period of time.

The Resolution Authority has the power to temporarily prevent secured creditors of a Resolution Firm or group company under resolution from enforcing security interests in relation to any assets of that institution under resolution from the publication of a notice of the restriction in accordance with section 137 para 1 SAG until the end of the business day following that publication (section 83 para 1 SAG).[74] Such restrictions do not apply in relation to any security interest provided by the Resolution Firm or group company under resolution to Systems, system operators within the meaning of section 1 para 16a KWG, central counterparties within the meaning of section 1 para 31 KWG authorised in the European Union pursuant to Article 14 EMIR, as well as third country central

[73] Section 82 para 1 sentence 3 SAG states that the Resolution Authority needs to consider the circumstances of the individual case and sentence 6 excludes such suspension if measures under section 66a SAG have already been instituted.

[74] Section 83 SAG does not apply where measures under section 66a SAG have already been instituted.

counterparties recognised by ESMA pursuant to Article 25 EMIR and central banks.

Under section 84 para 1 SAG the Resolution Authority is entitled to suspend the termination rights[75] of any party to a contract with a Resolution Firm or group company under resolution from the publication of such suspension pursuant to section 137 para 1 SAG until the end of the business day following that publication. [76] The Resolution Authority may also suspend the termination rights of any party to a contract with a group company forming part of the group of an institution under resolution from the publication of such suspension pursuant to section 137 para 1 SAG until the end of the business day following that publication where (1) the obligations under that contract are guaranteed or are otherwise supported by the group company under resolution, (2) the termination rights under that contract are based solely on the insolvency or the conditions for resolution or the institution or implementation of resolution actions and (3) in the case of a transfer power that has been or may be exercised in relation to the institution or group company under resolution, (i) all rights and liabilities of the Resolution Firm or group company under resolution of the subsidiary relating to that contract have been or may be transferred to and assumed by the recipient or (ii) the Resolution Authority provides in any other way adequate protection for the rights of the other parties (section 84 para 2 SAG). Again, exemptions from such suspension of termination rights apply for participants in Systems, System operators within the meaning of section 1 para 16a KWG, central counterparties within the meaning of section 1 para 31 KWG authorised in the European Union pursuant to Article 14 EMIR, as well as third country central

[75] Section 84 para 7 SAG states that section 84 SAG applies to all termination events arising under a contract with a Resolution Firm or group company in resolution which, in our view, should also include automatic termination rights.

[76] Section 84 SAG does not apply where measures under section 66a SAG have already been instituted.

counterparties recognised by ESMA pursuant to Article 25 EMIR and central banks.

A party may exercise a termination right under a contract before the end of the period referred to in paragraphs 1 or 2 of section 84 SAG if that party receives notice from the Resolution Authority under section 84 para 5 SAG that the rights and liabilities covered by the Rulebook are (i) not to be transferred to another entity and (ii) not subject to write down or conversion upon the application of the bail-in tool. Subject to sections 82 and 144 SAG, where no notice has been given pursuant to section 84 para 5 SAG, such a creditor of a Relevant Clearing Member may exercise termination rights after the expiry of the period of suspension if, (1) in cases where the rights and liabilities covered by the contract have been transferred to a recipient entity, the contractual requirements for terminating the contract are still met after the transfer to the recipient entity and (2) in cases where the rights and liabilities covered by the contract remain with the Resolution Firm or group company under resolution and the Resolution Authority has not applied the bail-in tool, the contractual requirements for terminating the contract are still met upon the expiry of the suspension.

(B) SRMR

The BRRD treats the aforementioned powers as specific resolution powers, however, the SRMR does not specifically refer to such powers and it is not entirely clear whether such powers can be exercised by the Resolution Authority when implementing decisions under the SRMR.[77] However, to the extent these powers protect the rights of the relevant parties such as with respect to financial collateral or systems, they would qualify as "safeguards" and, when implementing any

[77] Article 29 SRMR governs the implementation of decisions by the national resolution authorities, but only refers to the safeguards under BRRD and not to any additional powers.

decisions under the SRMR, the Resolution Authority needs to ensure that the applicable safeguards provided for in BRRD are complied with (Article 29 para 1 subpara 3 SRMR).

(viii) Statutory safeguards

Pursuant to section 144 para 1 SAG, a crisis prevention measure or a crisis management measure (*Krisen-managementmaßnahme*), including the occurrence of any event directly linked to the application of such a measure, shall not in relation to the Resolution Firm or the group and all group companies be deemed to be an enforcement or termination event within the meaning of the FCD or as insolvency proceedings within the meaning of the SFD provided that the main obligations (*Hauptleistungspflichten*) under the contract, including payment and delivery obligations and the provision of collateral, continue to be performed.

Under section 144 para 3 SAG, a crisis prevention measure, a measure under section 66a SAG or crisis management measure, including the occurrence of any event directly linked to the application of such a measure, do not entitle a party to (1) exercise any termination, suspension, modification, netting (*Verrechnung*) or set-off rights *vis-à-vis* a Resolution Firm or group company, (2) acquire title over any property of the Resolution Firm or group company, exercise control over it or enforce any rights under a security and (3) impair any contractual rights of the Resolution Firm or group company. This does only apply if the main obligations under the contract, including payment and delivery obligations, and provision of collateral, continue to be performed. A suspension or restriction under sections 82 to 84 SAG is not regarded as non-performance of contractual main obligations.[78]

[78] With respect to financial contracts governed by the laws of a non-EU Member State and generally coming into existence after 1 January 2016, the Resolution Firm is obliged to agree on contractual terms with relevant

Section 144 SAG does not affect the right of a person to take an action referred to in paragraph 3 of section 144 SAG where that right arises by virtue of an event other than the crisis prevention measure, the crisis management measure or the occurrence of any event directly linked to the application of such a measure. Section 144 para 5 SAG provides that agreements violating sections 144 para 1 to 3 SAG are not enforceable. As section 144 para 5 SAG implements Article 68 para 6 BRRD (which clarifies that the provisions of the BRRD implemented by section 144 SAG are to be considered as overriding mandatory provisions within the meaning of Article 9 Rome I)[79] we understand that section 144 SAG would be enforced in accordance with Article 9 Rome I even where German courts do not have jurisdiction. However, we do not opine on whether or not section 144 SAG would be recognised in any jurisdiction other than Germany.

(ix) "No creditor worse off" principle

(A) SRMR

With respect to the SRM, Article 15 para 1 lit (g) SRMR provides that no creditor shall incur greater losses than would have been incurred if an SRMR Institution had been wound up under normal insolvency proceedings in accordance with the safeguards provided for in Article 29

creditors pursuant to which the creditors recognise that section 144 para 3 SAG may be applied to such financial contracts and to obtain the creditors' consent to the application of such powers (section 60a SAG).

[79] Article 9 para 2 Rome I provides that the conflict of law provisions under Rome I do not restrict the application of the overriding mandatory provisions of the law of the forum and Article 9 para 3 sentence 1 Rome I provides that effect may be given to the overriding mandatory provisions of the law of the country where the obligations arising out of the contract have to be or have been performed, insofar as those overriding mandatory provisions render the performance of the contract unlawful. An overriding mandatory provision as defined in Article 9 para 1 Rome I is a provision which is regarded as crucial by a country for safeguarding its public interests, such as its political, social or economic organization, to such an extent that such provision is applicable to any situation falling within its scope, irrespective of the law otherwise applicable to a contract under Rome I. Pursuant to Recital 37 of Rome I the concept of overriding mandatory provisions should be distinguished from the expression "provisions which cannot be derogated from by agreement" and should be construed more restrictively.

SRMR. Creditors are entitled to compensation under Article 76 para 1 lit (e) SRMR from the Single Resolution Fund if, following an evaluation pursuant to Article 20 para 5 SRMR they have incurred greater losses that they would have incurred, following a valuation pursuant to Article 20 para 16, in a winding up under normal insolvency proceedings.

(B) SAG

Under section 146 SAG the Resolution Authority must ensure that, immediately after the resolution action or actions have been effected a valuation is carried out by an independent person (such valuation must be distinct from the valuation carried out under section 69 SAG) to assess if and to what extent shareholders and creditors would have received better treatment if the institution under resolution had been subject to normal insolvency proceedings. If such assessment shows that creditors are worse off than they would have been in insolvency proceedings, such creditors are entitled to seek compensation from the German bank restructuring fund (*Restrukturierungsfonds*) (section 147 SAG).

This means that creditors of Relevant Clearing Members that are Resolution Firms should at least receive compensation if the imposition of resolution measures results in a situation where they would be more detrimentally affected than in Insolvency Proceedings. In this respect, where German law applies it should be assessed whether relevant transactions fall within the scope of section 104 InsO and, accordingly, would not be subject to a Selection Right by the Insolvency Administrator or if transactions qualify as mutual transactions which have not been completely fulfilled by one party and, therefore, are not protected by section 104 InsO (see paragraph 3.2.3(c)).

(x) Legal remedies

Since the SRB is an EU institution, legal remedies would be available at the European courts.[80] A resolution action may be challenged before the VGH Kassel within one month upon its publication (section 179 SAG). The law does not expressly foresee any appeal against any such judgment, although legal remedies may from time to time be available under generally applicable laws, including German constitutional law. The filing

[80] Pursuant to Article 263 para 1 sentence 2 of the (consolidated version of the) Treaty on the Functioning of the European Union (OJ EU No C 326 of 26 October 2012, p. 1) the Court of Justice of the European Union shall review the legality of acts of bodies, offices or agencies of the Union intended to produce legal effects vis-à-vis third parties. This should also include the SRB, however, it is not entirely clear whether the Court of Justice of the European Union is also the competent court when challenging any legal acts by the Resolution Authority when acting to implement any decisions of the SRB. The court from which legal protection can be obtained depends on the authority acting and the legal nature of the challenged measure. In constellations such as the present one, the principle of procedural separation generally applies. According to this principle, the national courts have jurisdiction in so far as national authorities have acted in a binding external capacity, while the European jurisdiction is competent to the extent that the European authority has acted externally. The SRB draws up the resolution concept, which must be implemented by the Resolution Authority (Article 18 para 1 to 6, 9 SRMR). In Germany the implementation regularly takes the form of an administrative act pursuant to section 35 of the German Federal Act on Administrative Proceedings (*Verwaltungsverfahrensgesetz*). The lawfulness of this administrative act is reviewed by the VGH Kassel according to section 150 SAG. If the administrative act is based on an instruction of the SRB, the examination competence of the VGH Kassel is limited solely to the exercise of the Resolution Authority's discretion. If, on the other hand, the legality of the instruction of the SRB is to be reviewed, the decision lies with the Court of Justice of the European Union. If the VGH Kassel assumes that the instruction is invalid, it must refer this question of law to the Court of Justice of the European Union within the framework of a preliminary ruling procedure pursuant to Article 267 para 1 lit. (b) TFEU. Apart from this principle, in certain constellations there is a possibility of legal remedies directly against decisions of the SRB. On the one hand, this concerns the exceptional case that an Resolution Authority has not implemented or complied with the decision of the SRB or has implemented it in such a way that the resolution objectives or the efficient implementation of the resolution concept are endangered. On the other hand, the SRMR provides for a separate system of legal protection against resolutions of the SRB. If one of the resolutions of the SRB enumerated in Article 85 para 3 SRMR is concerned, a two-stage legal protection system consisting of a complaint procedure and a subsequent action procedure before the courts of the European Union applies. Legal protection against decisions not listed in Article 85 para 3 SRMR is possible in the form of an action for annulment and in addition, there is (theoretically) the possibility of bringing an action for failure to act in order to force the SRB to perform its tasks (see *Schmitt,* in Jahn/Schmitt/Geier, Handbuch Bankensanierung und -abwicklung, 1st ed. (2016), section B. XII.; *Thiele,* GewArch 2015, 157, 159).

of a law suit does not suspend or otherwise affect the validity of a relevant resolution action.

(xi) Summary

To summarise, upon the imposition of crisis prevention measures or crisis management measures in respect of a Resolution Firm, contractual termination, set-off or netting rights as well as the enforcement of security may be temporarily suspended or otherwise restricted or affected, subject to applicable exemptions.

Claims against a Relevant Clearing Member that is a Resolution Firm may be subject to mandatory conversion or write off and may also be transferred to another party and/or modified although a partial transfer would be excluded to the extent such rights and obligations are part of a netting arrangement. For derivatives transactions, the bail-in tool may only be applied after or simultaneously with the "closing-out" of such derivatives.

If the Netting Provisions are not triggered before any SAG measures are imposed and before restrictions under the InsO apply, measures that temporarily prevent a creditor of a Relevant Clearing Member that is a Resolution Firm from exercising termination rights to trigger the close-out netting mechanism may impact the timing of the close-out netting and, if the respective Relevant Clearing Member that is a Resolution Firm subsequently becomes insolvent, this may (in particular in conjunction with the temporary suspension of enforcement, set-off or netting rights under the SAG) result in a situation where the counterparty would continuously be prevented from exercising any termination, set-off or netting rights, first under the SAG and subsequently under the InsO. However, the following exemptions and mitigating factors should apply to each scenario:

A temporary stay of enforcement rights can be imposed on liabilities due by a Relevant Clearing Member that is a Resolution Firm. However, such restrictions do not apply to Systems, system operators within the meaning of section 1 para 16a KWG, central counterparties within the meaning of section

1 para 31 KWG authorised in the European Union pursuant to Article 14 EMIR, as well as third country central counterparties recognised by ESMA pursuant to Article 25 EMIR and central banks.

Creditors of a Relevant Clearing Member that is a Resolution Firm cannot exercise termination rights based exclusively on the imposition of crisis prevention or crisis management measures as long as the respective Relevant Clearing Member continues to perform the main obligations under the Rulebook. However, as soon as such Relevant Clearing Member ceases to perform its main obligations, such creditor would be entitled to exercise its termination rights.

(f) International scope of application of Regulatory Proceedings

In accordance with section 46d para 3 sentence 3 KWG, section 340 para 2 InsO which provides for specific conflicts of law rules for "netting agreements" (*Schuldumwandlungsverträge und Aufrechnungsvereinbarungen*) applies by analogy to reorganisation measures (*Sanierungsmaßnahmen*). The same applies to section 340 para 3 InsO which provides for specific conflicts of law rules applicable to participants in a System. Among such reorganisation measures are, in particular, measures taken under section 46 KWG which are intended to preserve or restore the financial status of a CRR Credit Institution and which may affect existing rights of third parties in a host member state of the European Economic Area ("**EEA**") (section 46d para 3 sentence 1 KWG). The view of the German legislator appears to be that such "reorganisation measures" qualify as "reorganisation measures" as defined in Article 2 no. 7 WUD because section 46d para 1 sentence 1 KWG requires BaFin to inform the competent authorities of host EEA member states when taking "reorganisation measures" under the KWG.[81] However, the scope of section 46d para 3 KWG is not clear as the term "reorganisation measure" is not used elsewhere in the KWG. In such

[81] BT-Drucksache 17/3024, p. 49. As mentioned, Article 117 BRRD provides for certain changes to the WUD and in particular extends the scope of institutions subject to the WUD (previously only CRR Credit Institutions) to also include CRR Investment Firms. Key provisions of the WUD are implemented in Germany by sections 46d and 46e KWG but it is not entirely clear whether the general widening of the scope of covered entities means that all provisions of the WUD must be construed accordingly. In contrast to section 46e KWG, section 46d KWG has not been amended to cover CRR Investment Firms.

case, sections 338 and 340 InsO would be applicable and if a court were to follow our interpretation of sections 338 and 340 para 2 InsO (paragraph 3.2.3(b)(ii)), the effects of the regulatory measures and reorganisation proceedings on Contracts would therefore have to be decided on the basis of English law as the law governing the Rulebook and Contracts.[82]

There is no similar provision in the SAG and section 46d KWG does not refer to the SAG. However, Article 25 WUD as amended by the BRRD clarifies that without prejudice to Articles 68 and 71 BRRD netting agreements are to be governed solely by the law of the contract which governs such agreements (Article 25 WUD has been implemented in Germany by section 340 para 2 InsO but section 340 InsO has not been amended following the amendment of Article 25 WUD). We understand and construe the reference to Articles 68 and 71 BRRD to allow for the exclusion of certain contractual rights and the suspension of termination rights irrespective of the law governing the relevant netting agreement and, thus, as a special conflict of laws provision. We do not express any opinion as to whether the complete implementation of Article 25 WUD will lead to further changes of German law or whether the German legislator considers that Article 25 WUD has already been fully implemented.[83]

Under German law, the termination restrictions under section 144 SAG (which implements Article 68 BRRD) are considered to qualify as overriding mandatory provisions within the meaning of Article 9 para 1

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[82] However, absent any authoritative precedents from courts and at least a detailed analysis in legal literature, it is unclear whether a German court would also apply Article 9 Rome I and, if so, in which way the court would resolve the conflict between section 340 InsO on the one hand and the direct application of overriding mandatory provisions of German law under Article 9 Rome I on the other hand. We believe that any potential conflict between section 340 InsO and Article 9 Rome I should be solved in favour of section 340 InsO to the extent the relevant provision directly refers to section 340 InsO, as section 340 InsO is more specific than the generally applicable Article 9 Rome I and such reference shows in our view the intention of the legislator to achieve a higher degree of clarity and certainty on application of the relevant applicable laws.

[83] Please refer to *Lindemann*, in: Boos/Fischer/Schulte-Mattler, KWG/CRR, 5th ed. (2016), § 46d KWG no. 17, arguing that resolution measures under the SAG would also fall under section 46d KWG. If a court follows this view such court would then also need to apply section 46d para 3 sentence 3 KWG which, as mentioned, refers to section 340 InsO.

Rome I.[84] Thus, a German court would generally have to recognise the termination restrictions, irrespective of the law governing the transactions (Article 9 para 2 Rome I). However, to the extent bound by Rome I, a court outside Germany would have to consider applying such termination restrictions only if the obligations arising out of the transactions had to be or have been performed in Germany (Article 9 para 3 Rome I). In such case, effect may be given to the overriding mandatory provisions of German law, in so far as those overriding mandatory provisions render the performance of the contract unlawful. The fact that the termination restrictions under section 144 SAG are from a German law perspective overriding mandatory provisions within the meaning of Article 9 para 1 Rome I, would not require a court outside Germany to apply the termination restrictions if obligations arising out of the transactions were not to be performed in Germany.

We are not aware of any guidance from BaFin, the ECB or the Resolution Authority or court decisions on the SAG and the aforementioned provisions of the KWG.

(g) Exemptions for Financial Collateral

Specific exemptions from certain mandatory restrictions apply to financial collateral as defined in section 1 para 17 KWG ("**Financial Collateral**") which comprises cash deposits (*Barguthaben*), cash amounts (*Geldbeträge*), securities, money market instruments and other credit claims within the meaning of Article 2 para 1 lit (o) FCD[85] and payment claims under an agreement pursuant to which an insurance company as defined in section 1 para 1 of the German Insurance Supervisory Act (*Versicherungsaufsichtsgesetz,* "**VAG**") has granted credit in the form of a loan in each case including all related rights or claims which have been transferred as collateral either by way of an *in rem* security arrangement (*beschränktes dingliches Sicherungsrecht*) or

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[84] See Article 68 para 6 BRRD and BT-Drucksache 18/2575, p. 187, stating that section 144 SAG is intended to implement Article 68 BRRD.

[85] Article 1 para 6 FCD as amended states that Articles 4 to 7 FCD do not apply to any restriction on the enforcement of financial collateral arrangements or any restriction on the effect of a security financial collateral arrangement, any close out netting or set-off provision that is imposed by virtue of Title IV, Chapter V or VI of BRRD, or to any such restriction that is imposed by virtue of similar powers in the law of a Member State to facilitate the orderly resolution of any entity referred to in points (c)(iv) and (d) of paragraph 2 which is subject to safeguards at least equivalent to those set out in Title IV, Chapter VII of BRRD.

by way of a money transfer or by way of full title transfer on the basis of an agreement between a secured party and a security provider[86], each belonging to one of the categories named in Article 1 para 2 lit (a) to (e) FCD.[87] Claims based on credits granted by an insurance company are only covered if the secured party is located in Germany.

Should the security provider be a person or business undertaking named in Article 1 para 2 lit (e) FCD, financial collateral is only given, if the

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[86] The FCD provides in Article 2 para 2 that "References in this Directive to financial collateral being "provided", or to the "provision" of financial collateral, are to the financial collateral being delivered, transferred, held, registered or otherwise designated so as to be in the possession or under the control of the collateral taker or of a person acting on the collateral taker's behalf. Any right of substitution or to withdraw excess financial collateral in favour of the collateral provider or, in the case of credit claims, right to collect the proceeds thereof until further notice, shall not prejudice the financial collateral having been provided to the collateral taker as mentioned in this Directive." The ECJ (C-156/15 of 10 November 2016) dealing with the question what "control" means with respect to collateral in respect of monies deposited in a bank account, has ruled that "the taker of collateral… in the form of monies lodged in an ordinary bank account may be regarded as having acquired 'possession or control' of the monies only if the collateral provider is prevented from disposing of them." There is no express reference in section 1 para 17 KWG to "control", but we are of the view that the term "provide" in that section would need to be interpreted in conformity with European Union law. To the extent that the security provider is entitled to dispose over collateral (at least in cases which do not relate to a right to substitution or withdrawal of excess collateral), there would be a risk that a court could take the view that the qualification as Financial Collateral is endangered.

[87] An extract from Article 1 para 2 lit (a) to (e) FCD reads as follows:

"The collateral taker and the collateral provider must each belong to one of the following categories:

[…]

(c) a financial institution subject to prudential supervision including:

(i) a credit institution as defined in Article 4(1) of Directive 2006/48/EC, including the institutions listed in Article 2 of that Directive;

(ii) an investment firm as defined in Article 4(1)(1) of Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments;

(d) a central counterparty, settlement agent or clearing house, as defined respectively in Article 2(c), (d) and (e) of Directive 98/26/EC, including similar institutions regulated under national law acting in the futures, options and derivatives markets to the extent not covered by that Directive, and a person, other than a natural person, who acts in a trust or representative capacity on behalf of any one or more persons that includes any bondholders or holders of other forms of securitised debt or any institutions as defined in points (a) to (d);

(e) a person other than a natural person, including unincorporated firms and partnerships, provided that the other party is an institution as defined in points (a) to (d)."

Please refer to Article 94 MiFID II stating that references to Directive 2004/39/EC need to be construed as references to MiFID II and references to terms defined in, or Articles of, Directive 2004/39/EC need to be

collateral secures obligations arising under agreements or the procurement of agreements which serve the (a) acquisition and sale of financial instruments, (b) sale and repurchase, lending or similar transactions on financial instruments or (c) loans to finance the acquisition of financial instruments.

As we understand, Relevant Clearing Members are Institutions licensed in accordance with MiFID II or CRD IV[88] and, if this is the case, they fall within the scope of Article 1 para 2 lit (c) FCD. Security created over cash deposits, cash amounts and securities in the form of outright transfers would be eligible for creating Financial Collateral. While LCH would still qualify as a CCP, it would no longer fall under Article 1 para 2 lit (d) FCD, as LCH would not be regulated under the national law of an EU member state.[89] This is irrespective of the definition of Financial Collateral under the KWG as section 1 para 17 KWG refers directly to the FCD. Hence, LCH would only qualify as an entity within the meaning of Article 1 para 2 lit (e) FCD. However, we do not believe that this significantly limits LCH's ability to make use of the relevant exemptions for Financial Collateral. Even if LCH is acting as security provider the relevant collateral would still qualify as Financial Collateral to the extent it secures obligations to the Relevant Clearing Members

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construed as references to the equivalent term defined in, or Articles of, MiFID II they would fall within the scope of Article 1 para 2 lit (c) (i) or, respectively (ii) FCD.

88 Article 4 para 1 point 1 CRD IV refers to Article 4 para 1 CRR. See also footnote 17 as only CRR Credit Institutions would be covered by Article 4 para 1 CRR. Subject to certain exemptions, section 1a para 1 KWG extends the application of the CRR also to German Credit Institutions which do not qualify as CRR Credit Institutions. While this is not directly addressed in section 1a para 1 KWG we hold the view that such reference is also meant to extend the scope of the FCD to such Credit Institutions as otherwise Financial Services Institutions would be covered but not Credit Institutions not qualifying as CRR Credit Institutions. Excluding Credit Institutions not qualifying as CRR Credit Institutions from the scope of FCD (and thus from certain protection in the event of an insolvency of a counterparty) appears to be counterproductive and as such cannot have been intended by the legislator since the relevant exemptions under the FCD as implemented into German law create the necessary legal certainty for applying certain techniques relevant for the capital treatment under CRR. We also note that the wording of Article 2(c) FCD refers to financial institutions subject to prudential supervision including those mentioned in Article 2(c)(i) to (vi) FCD. We are not aware of any court decision on this question.

89 We note, however, that the English version of the FCD merely refers to "national law" (similar to the French version (*régis par la législation nationale*) and the Spanish version (*reguladas por el Derecho nacional*)), while the German version (*Aufsicht nach dem Recht eines Mitgliedstaats*) refers to the laws of a Member State. However, an explicit reference to national law would not make much sense if this were to be intended to cover the laws of each and every country in which the relevant central counterparty is located.

(which are covered by Article 1 para 2 lit (c) FCD) arising under agreements or the procurement of agreements which serve the (a) acquisition and sale of financial instruments, (b) sale and repurchase, lending or similar transactions on financial instruments or (c) loans to finance the acquisition of financial instruments. While section 1 para 17 KWG is a German regulatory provision, whether the relevant agreement falls within such category is a matter of the respective governing law. Assuming that the relevant wording provided in the Rulebook sufficiently characterises the nature of the Contracts and under English law, on which we do not opine, such Contracts would not be characterised otherwise, the relevant Contracts should in our view qualify as sale or purchase agreements.

Section 21 para 2 sentence 2 InsO provides that the institution of Provisional Insolvency Measures under section 21 InsO must not affect the validity of dispositions (*Verfügungen*) over Financial Collateral. The same applies, if Financial Collateral is created on the day on which such order was released, provided the security taker can prove that it neither had been aware of, nor had to be aware of, such release.

Section 46 para 2 sentence 6 KWG provides that exemptions for Financial Collateral under the InsO apply analogously in respect of measures under section 46 para 1 sentence 2 no. 4 to 6 KWG (section 46 para 2 sentence 6 KWG). An exemption for Financial Collateral is contained in section 79 para 6 SAG pursuant to which the Resolution Authority may not modify the provisions of a contract with a Resolution Firm or group company under resolution in connection with the transfer of assets or liabilities to a recipient entity. Section 83 SAG, which empowers the Resolution Authority to restrict the enforcement of security, does not exempt Financial Collateral.[90]

Dispositions of Financial Collateral made after the opening of Insolvency Proceedings are valid (subject to any challenge in insolvency), provided that such dispositions were made on the day of the opening of Insolvency Proceedings and the other party proves that it

[90] This is in line with the BRRD which does not provide for such an exemption (Article 69 BRRD) and modifies the FCD so as to provide that the imposition of measures under Title IV, Chapters IV and V BRRD do not fall within the scope of potential impediments to the enforcement of security that member states must remove under the FCD (Article 118 BRRD). Further, pursuant to Article 9a FCD the FCD is generally without prejudice to the BRRD.

did not know, nor should have known, of the opening of the Insolvency Proceedings (section 81 para 3 sentence 2 InsO). Financial Collateral further benefits from certain exemptions in respect of insolvency-related set-off and challenge in insolvency (paragraphs 3.2.3(i)(iv) and 3.2.4(b)) and the enforcement of security (paragraph 3.2.2(c)). Further, section 104 para 1 sentence 3 no. 6 InsO expressly refers to Financial Collateral as types of arrangements that are in scope of such section and therefore not subject to the Insolvency Administrator's Selection Right (see the detailed analysis of section 104 InsO below at paragraph 3.2.2(c)(ii)).

(h) Exemptions for Systems

Further specific exemptions from certain mandatory restrictions apply to systems (*Systeme*) as defined under section 1 para 16 KWG ("**Systems**"). A System is a written agreement within the meaning of Article 2 lit (a) SFD, including an agreement between a participant and an indirectly participating credit institution which has been notified by Deutsche Bundesbank or a competent authority of an EU member state of the EEA to the European Securities and Markets Authority ("**ESMA**"). Systems from third countries are treated similar to the systems referred to in sentence 1 if they largely correspond with the requirements enumerated in Article 2 lit (a) SFD.[91]

Article 2 lit (a) SFD defines "system" as follows:

"'system' shall mean a formal arrangement

- between three or more participants, excluding the system operator of that 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,

- governed by the law of a Member State chosen by the participants; the participants may, however, only choose the law

[91] This is based on Recital 7 SFD, as we understand.

of a Member State in which at least one of them has its head office, and

– designated, without prejudice to other more stringent conditions of general application laid down by national law, 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.

Subject to the conditions in the first subparagraph, a Member State may designate as a system such a formal arrangement whose business consists of the execution of transfer orders as defined in the second indent of (i) and which to a limited extent executes orders relating to other financial instruments, when that Member State considers that such a designation is warranted on grounds of systemic risk.

A Member State may also on a case-by-case basis designate as a system such a formal arrangement between two participants, without counting a possible settlement agent, a possible central counterparty, a possible clearing house or a possible indirect participant, when that Member State considers that such a designation is warranted on grounds of systemic risk.

An arrangement entered into between interoperable systems shall not constitute a system."

Accordingly, pursuant to Article 2 lit (a) SFD Systems established within the EU have to be entered in the list of Designated Payment and Securities Settlement Systems maintained by ESMA.[92] Following the United Kingdom leaving the EU and the transition period expiring, the United Kingdom would qualify as a third country and LCH would no longer appear in such list. Hence, LCH would need to meet the requirements under German law for third country systems to qualify as System.

(i) System within the meaning of section 1 para 16 KWG

[92] Available at https://www.esma.europa.eu/sites/default/files/library/designated_payment_and_securities_settlement_systems.pdf.

Under German law (section 1 para 16 KWG in connection with Article 2 lit (a) SFD), a System is a formal arrangement between three or more participants which consists of standardised terms, is intended to be used with various clearing members and, amongst other things, provides for the clearing through a central counterparty or for the execution of transfer orders of participating clearing members in the course of the settlement. Even if it could be argued that the wording "formal arrangement between three or more participants" on its face appears to require that all contractual relationships are multilateral agreements, this interpretation is, in our view, not compelling. A formal arrangement between three or more participants also exists when a number of bilateral arrangements are concluded, with one party being a party to all of such arrangements, which are accordingly linked by all members submitting to the same rules.[93] In our view, in order to provide for legal certainty with respect to the applicable laws in the case of insolvency and in view of legislative history (including the implementation of EMIR[94]), the definition of System should be interpreted widely,[95] so that also bilateral arrangements within the same comprehensive formal

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93 The reference to clearing in the definition of 'system' under the SFD was implemented through Directive 2009/44/EC of the European Parliament and of the Council of 6 May 2009 amending Directive 98/26/EC on settlement finality in payment and securities settlement systems and Directive 2002/47/EC on financial collateral arrangements as regards linked systems and credit claims.

94 In relation to the authorisation of EU CCPs under EMIR, Article 17 para 4 EMIR requires that the competent authority shall grant authorisation only where it is fully satisfied that the CCP is notified as a system pursuant to the SFD. Given the role of a CCP under EMIR, we would construe the reference to such notification such that not only the payment and settlement function, but also the clearing function can be regarded as a System, and we would also construe such reference as a clarification of the scope of the SFD generally. Further, since the entering into force of BRRD 2, Article 2 lit (c) SFD defines a central counterparty as a CCP as defined in point (1) of Article 2 EMIR.

95 We note that the definition of 'netting' in the SFD and Article 3 SFD only refers to the conversion into one net claim or one net obligation of claims and obligations resulting from transfer orders, but do not expressly refer to the clearing function referred to in the definition of 'system' under the SFD. While it is therefore not entirely clear whether this is intended to limit the application of this provision to transfer orders in respect of cash and securities, this would appear contrary to the introduction of the reference to clearing. Further, section 340 para 3 InsO in connection with section 1 para 16 KWG, which implements the SFD, refers to the SFD's definition of 'system' (which includes the reference to clearing) as such without mentioning transfer orders and therefore appears to have been implemented to include the clearing function generally.

arrangement, such as LCH having established in the Rulebook, can form a System.[96]

(ii) Third-country systems

Pursuant to section 1 para 16 sentence 2 KWG third country systems would also qualify as System if they "largely" correspond with the requirements mentioned in Article 2 lit (a) SFD. Accordingly, despite the choice of the laws of a jurisdiction outside the EU, a third country system may still qualify as a System if the other requirements of Article 2 lit (a) SFD are met. Otherwise, the reference to third country systems would not make much sense as it cannot be assumed that a third country system is governed by the laws of an EU member state.[97] While the effect of section 1 para 16 sentence 2 KWG is, in our view, that arrangements governed by the law of a country outside the EU may qualify as a System for purposes of German law, there is no public register of such third country systems.[98]

The Rulebook is a formal arrangement between three or more participants, with common rules and standardised arrangements for the clearing through a central counterparty of transfer orders between the participants.[99] As a third country system would not

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96 See also *Brambring*, Zentrales Clearing von OTC-Derivaten unter EMIR, 2017, p. 348 *et seqq*., differing view *von Hall*, Insolvenzverrechnung in bilateralen Clearingsystemen, 2011, p. 170 *et seqq*.

97 Please also refer to BR-Drucksache 456/99, p. 21.

98 With respect to the register maintained by ESMA pursuant to Article 10 para 1 SFD, see footnote 92 above. ESMA further maintains a list of third country CCPs having been recognised to offer services and activities in the EU, available under https://www.esma.europa.eu/sites/default/files/library/third-country_ccps_recognised_under_emir.pdf., this recognition is however not based on the third country CCP complying with the EMIR requirements for CCPs but instead relies on the CCPs to be fully compliant with their local regime and be effectively supervised domestically when the applicable CCP regime has been deemed equivalent.

99 While the definition of transfer order under Article 2 lit (i) SFD refers to "any instruction by a participant to place at the disposal of a recipient an amount of money … or any instruction which results in the assumption or discharge of a payment obligation as defined by the rules of the system, or an instruction by a participant to transfer the title to, or interest in, a security or securities …", we believe that, by extending the definition of systems under Article 2 lit (a) SFD to cover clearing (see Article 1 Directive 2009/44/EC of the European Parliament and of the Council of 6 May 2009 amending Directive 98/26/EC on settlement finality in payment and securities settlement systems and Directive 2002/47/EC on financial collateral arrangements as regards

be governed by the laws of a member state and a third country systems is not capable of being entered into the list of Designated Payment and Securities Settlement Systems, we believe that, when referring to the requirements under Article 2 lit (a) SFD, section 1 para 16 sentence 2 KWG needs to be construed to refer to the first indent of lit (a). Hence, LCH would qualify as a third country system under German law and thus be subject to any relevant exemptions referring to Systems. We also believe that to qualify as a third country system under German law, LCH would not need to apply formally to BaFin or Bundesbank, including a notification under section 24b KWG.[100] We are not aware of any court decisions on the interpretation of third country systems under section 1 para 16 sentence 2 KWG and a court may not follow our analysis.

In Insolvency Proceedings specific conflict of laws provisions apply with respect to rights and obligations of participants in Systems (section 340 para 3 InsO (paragraph 3.2.3(b)(iii)). Within the scope of application of the InsO, exemptions for Systems apply with respect to insolvency related set-off (paragraph 3.2.3(i)(v)) and the enforcement of security (paragraph 3.2.2(c)(ii)). Such exemptions apply analogously to measures under section 46 para 1 sentence 2 no. 4 to 6 KWG (section 46 para 2 sentence 6 KWG). Systems as well as central counterparties within the meaning of section 1 para 31 KWG authorised in the European Union pursuant to Article 14 EMIR, as well as third country central counterparties recognised by ESMA pursuant to Article 25 EMIR are also protected under sections 66a para 3, 82 para 2, 83 para 3 and 84 para 4 SAG (paragraph 3.2.1(e)(vii)(A)). When implementing measures under the SRMR, the Resolution Authority needs to ensure that the safeguards provided for in BRRD are complied with when

linked systems and credit claims; OJ EU No L 146 of 10 June 2009, p. 37), transfer orders can be construed to cover payment and delivery obligations of relevant transactions subject to clearing.

[100] Section 24b KWG provides for an obligation of an Institution to notify BaFin and Bundesbank of its intention to operate a System. Implementing Article 10 para 1 sub-para 4 SFD, section 24b KWG provides that each Institution participating in a System is obliged to inform anyone with a legitimate interest of the Systems in which it participates and to provide information about the main rules governing the functioning of those Systems.

implementing decisions under the SRM (paragraph 3.2.1(e)(vii)(B)). This includes the aforementioned provisions under the SAG.

(i) Exemptions for clearing

Where German insolvency laws apply, Article 102b EGInsO might create an exemption with respect to Insolvency Proceedings and Provisional Insolvency Measures. Article 102b EGInsO was introduced into German law to ensure that the implementation of certain measures under Article 48 EMIR are not impaired by the opening of Insolvency Proceedings.

In accordance with Article 102b section 1 para 1 EGInsO the opening of Insolvency Proceedings must not impair (1) the performance of the necessary measures (*gebotene Maßnahmen*) to administer, close out or otherwise settle client positions and own account positions of a clearing member in accordance with Article 48 paras 2, 3, 5 sentence 3 and para 6 sentence 3 EMIR, (2) the necessary transfer of client positions in accordance with Article 48 paras 4 to 6 EMIR and (3) the necessary utilisation and disbursement of clients' collateral in accordance with Article 48 para 7 EMIR where such measures have been taken in accordance with Article 48 EMIR. Furthermore, Article 102b section 2 EGInsO provides that the measures referred to in section 1 of Article 102b EGInsO are not subject to insolvency challenge (see paragraph 3.2.4(b) below). Article 102b EGInsO also applies to Provisional Insolvency Measures.

Even though LCH is a recognised CCP under Article 25 EMIR, Article 48 EMIR would not apply to LCH and, hence, we believe that Article 102b EGInsO would neither apply as the wording of Article 102b EGInsO refers directly to necessary measures under Article 48 EMIR.[101]

[101] The legislative reasoning states that with respect to the type and the modalities of such measures Article 102b section 1 EGInsO refers completely to Article 48 EMIR which in our view would exclude the application of Article 102b EGInsO merely on the basis of a recognition under Article 25 EMIR; BT-Drucksache 17/11289, p. 28. Recital 7 EMIR states with regard to the recognition of third-country CCPs that a third country system for the recognition of CCPs authorised under foreign legal regimes "should be considered equivalent if it ensures that the substantial result of the applicable regulatory regime is similar to Union requirements and should be considered effective if those rules are being applied in a consistent manner". However, in light of the legislative reasoning referred to above and given that recognition under Article 25 EMIR relies on the CCPs to be fully compliant with their local regime and be effectively supervised domestically rather than

This would also be the case where the United Kingdom adopted national legislation reflecting Article 48 EMIR on a one-by-one basis. We are not aware of any court decisions on this matter.

(j) *Would any of the different types of insolvency proceedings and reorganisation measures 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?*

Rule 3 of the Default Rules provides that LCH may take steps as defined in Rule 6 of the Default Rules (among others, terminating all or part of the relevant Contracts) "… in the event of a Relevant Clearing Member appearing to the Clearing House to be unable, or to be likely to become unable, to meet its obligations in respect of one or more Contracts." While this provision is governed by English law (under which its preconditions - for example the term "likely" - and effects have to be construed and on which we do not opine), it appears that any steps may already be taken by LCH at an early stage, i.e. in the case of a likely payment default as regards one single Contract.

In any event, we understand that Rule 3 of the Default Rules generally enables LCH to take steps prior to the opening of Insolvency Proceedings. If applicable, upon the opening of Insolvency Proceedings, section 104 InsO provides for a mandatory automatic early termination of those Contracts which fall within the scope of section 104 InsO. If the relevant date for early termination falls after the opening of Insolvency Proceedings the provisions of section 104 InsO would prevail and govern the close-out netting of those Contracts which fall within its scope (see paragraph 3.2.3(c)). Please also refer to paragraph 3.2.3(c)(i) below whether there is a risk of any "cherry-picking right" being exercised.

LCH's right to take steps under Rule 3 of the Default Rules covers situations of financial difficulties of a Relevant Clearing Member at an early stage, and therefore could generally arise in situations already

relying on compliance with EMIR requirements such as those set out in Article 48, we do not believe that Article 102b EGInsO applies with respect to recognised third-country CCPs.

preceding the actual opening of Insolvency Proceedings, Provisional Insolvency Measures or Regulatory Proceedings under the laws of Germany. Subject to the interpretation of the Default Rules under English law, we cannot exclude that Regulatory Proceedings may be taken for reasons that do not (yet) affect the Relevant Clearing Member's ability to meet its obligations under a Contract (which would enable LCH to take steps in accordance with Rule 3 of the Default Rules). However, a general termination event preceding a situation in which a Clearing Member "… is likely to become unable, to meet its obligations in respect of one or more Contracts …" may be difficult to define and prove.

Provided that the relevant authority would fall under the definition of "Regulatory Body" (such term to be construed under English law on which we do not opine), the opening of Regulatory Proceedings themselves would also be covered by Rule 5(e) of the Default Rules: " … a Regulatory Body takes or threatens to take action against or in respect of the Clearing Member under any statutory provision or process of law …" as we would construe that provision (which is, however, a matter of English law, on which we do not opine).

Whether or not the relevant Resolution Authority qualifies as "Regulatory Body" is a matter of interpretation of the Rulebook which is governed by English law and on which we do not opine. We can also not exclude that measures under the SAG will be initiated before Rule 5(e) of the Default Rule is triggered. Furthermore the exercise of termination rights may be restricted by section 84 SAG (see paragraph 3.2.1(e)(vii)), however, this does not apply to Systems as well as central counterparties within the meaning of section 1 para 31 KWG authorised in the European Union pursuant to Article 14 EMIR, as well as third country central counterparties recognised by ESMA pursuant to Article 25 EMIR (section 84 para 4 SAG and paragraph 3.2.1(h)).

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?

We understand that under the Deed of Charge collateral is provided by the Relevant Clearing Member in favour of LCH to secure all obligations of that Relevant Clearing Member arising under and in connection with the Clearing Membership Agreement and the Clearing House's Rulebook. Collateral consists of securities and rights relating thereto and held by the Relevant Clearing Member with LCH as custodian in designated securities accounts. We understand that these accounts are established in England and the relevant account relationship is governed by English law. These accounts are subject to a security interest in favour of LCH under the Deed of Charge.

The Deed of Charge provides that all cash forming part of the collateral shall be paid to and retained by LCH in a cash account and any such monies which may be received by the Relevant Clearing Member shall pending such payment be held in trust for LCH. We further understand that the Deed of Charge does not permit LCH as the secured party to dispose of any of the Charged Property prior to a Default (as defined in the Deed of Charge) and that LCH does not become unrestricted title holder in the Charged Property. LCH does not acquire a right of reuse or comparable rights with respect to the Charged Property.

We first describe in the following paragraphs relevant German conflict of laws provisions and then analyse the application of these provisions to the security to be provided by Clearing Members to LCH under the Deed of Charge thereby mentioning steps to be taken by LCH to realise collateral.

(a) Security under German conflict of laws provisions

Under German law, a distinction has to be drawn between the contractual obligation to create security and the creation of the security itself. The obligation to provide security and the choice of English law to govern such obligation is recognised by the German courts under Article 3 para 1 Rome I. This holds true for the general obligation to enter into a Deed of Charge under LCH's Rulebook as a precondition for becoming a Clearing Member but also for the contractual obligations under the Deed of Charge which do not have an *in rem* aspect.

The law applicable to the creation of the security interest itself (i.e. the property law or *in rem* aspect of the Deed of Charge) needs to be determined on the basis of applicable German conflict of laws principles

and would, amongst other things, depend on the nature of the relevant collateral asset, its location and the rights the security provider gives to the secured party in respect of the relevant collateral asset. From a German law perspective, the law governing the creation of the relevant security interest also determines the rights of the secured party under such security interest. In respect of the security interest itself and depending on the type of security interest it should be noted that different legal and factual requirements must be fulfilled to ensure the validity of such security interest and, as a separate matter, its enforceability and the possibilities to enforce it.

(b) Conflict of laws provisions governing creation of a security interest

(i) Security over cash

Any cash forming part of the Charged Property as defined in the Deed of Charge must be paid by the Relevant Clearing Member to LCH. LCH will hold that cash in an account maintained in England and opened in its own name.

Cash credited to an account is represented by the payment claim of the relevant account holder against the entity maintaining the account, such as a bank or a custodian. Therefore, under German law, a security interest over cash credited to an account is established by creating a security interest in the relevant payment claim of the account holder against the relevant account bank. However, where the account is held in the name of the secured party, any transfers of cash made into such account *prima facie* constitute assets of the secured party and no security interest needs to be created over such account. In other words, where the cash is transferred to an account opened in the name of the secured party it is treated as an "outright title transfer" arrangement (*Vollrechtsübertragung*), rather than as a security interest (*Sicherheit* or *beschränkt dingliches Recht*). Where the cash is booked in an account held in the name of the security provider, a security interest over such account needs to be created.[102]

[102] Where an account is held in the name of the account holder but for the account of another person, for example a fiduciary account (*Treuhandkonto*), the secured party should verify whether the account holder may dispose

(ii) Security over contractual claims

Article 14 Rome I contains the relevant conflict of laws provisions for security over contractual claims. Article 14 para 1 Rome I provides that the relationship between assignor and assignee is governed by the law that applies to the contract between the assignor and assignee under Rome I, i.e. the parties may choose the governing law under Article 3 para 1 Rome I. Recital 38 of Rome I clarifies that this also covers the property aspects of the assignment in countries such as Germany where these aspects are legally separate from the law of obligations. The same applies in respect of pledgor and pledgee in case a claim is pledged (Article 14 para 3 Rome I). The law governing the pledged claim is relevant for determining whether the claim can be pledged, the relationship between the pledgee and the pledgor, the conditions under which the pledge can be invoked against the pledgor and whether the pledgor's obligations have been discharged (Article 14 para 2 Rome I).

In principle, if cash collateral is not provided by way of an outright title transfer, depending on the parties' agreement, different types of security interests over cash held in an account can be created under German law, such as a pledge (*Pfandrecht*) or an assignment for security purposes (*Sicherungsabtretung*) (please refer to paragraph 3.2.2(c)(i) as to mandatory rules on the enforcement of security in Insolvency Proceedings as defined in paragraph 3.2.1(a)). As mentioned above, transfer or payment of cash by the security provider to an account of the secured party

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of such account and validly create a security interest over such account and, as the case may be, the relevant beneficiary under such account has approved the creation of the security interest. If the secured party is aware that the account is a fiduciary account (*offenes Treuhandkonto*), the secured party cannot in good faith acquire a security interest in the beneficiary's assets booked into the account. If the secured party is not aware that the account is a fiduciary account (*verdecktes Treuhandkonto*), the secured party can acquire a security interest in the account. However, when a secured party later becomes aware the relevant account is a fiduciary account, it must not enforce a security interest acquired in such account or exercise any set-off rights (BGH WM 1990, 1954, 1955; BGH WM 1996, 249, 251; *Hadding/Häuser*, in: Schimansky/Bunte/Lwowski, Bankrechts-Handbuch, 5th ed. (2017), § 37 nos. 43 *et seq.*). This means that even if a security interest has been validly created over a fiduciary account because it was created without the awareness of the secured party, this can subsequently be frustrated by making a person that has taken such security subsequently aware of the fiduciary nature of the account.

should neither qualify as a pledge nor as an assignment for security purposes but as an "outright title transfer" in the cash.

(iii) Security over securities

Under German conflict of laws provisions, the validity of the transfer of title to securities is generally determined by the laws of the jurisdiction in which the securities are located (*lex cartae sitae*) in accordance with Article 43 EGBGB (*Wertpapiersachstatut*).[103] The following principles apply in respect of the *in rem* title to any physical certificate of a security. The rights represented by the securities (*Wertpapierrechtsstatut*) (e.g. the acquisition of voting, dividend or interest rights) are determined by the laws governing such right, for example in relation to shares the jurisdiction in which the issuer is located or established and in relation to bonds the jurisdiction the issuer has chosen to govern the bonds.

Subject to the rules on collectively held securities set out below, if the law governing the transfer of title to the securities provides that the transfer of title in the securities requires the delivery of a certificate (such as bearer securities under German law, *Inhaberpapiere*), the transfer of title to such securities is governed by the laws of the jurisdiction in which the certificate is physically located.[104]

In respect of negotiable registered securities (*Orderpapiere*), on the other hand, the analysis under German conflict of laws is different.[105] The law governing the rights represented by the securities (*Wertpapierrechtsstatut*) determines whether the transfer of the title to the negotiable registered securities requires an endorsement, delivery of the certificate or both. If negotiable registered securities bear a blank endorsement (*Blankoindossament*) and the law which governs the securities provides that the

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[103] *Welter*, in: Schimansky/Bunte/Lwowski, Bankrechts-Handbuch, 5th ed. (2017), § 26 nos. 178 *et seq.*; *Wendehorst*, in: Münchener Kommentar BGB, 8th ed. (2021), Article 43 EGBGB nos. 200 *et seq.; Mansel,* in: Staudinger BGB, Neubearbeitung 2015 (as of 17th December 2020), Annex to Article 43 EGBGB no. 29.

[104] *Wendehorst*, in: Münchener Kommentar BGB, 8th ed. (2021), Article 43 EGBGB no. 203.

[105] *Wendehorst*, in: Münchener Kommentar BGB, 8th ed. (2021), Article 43 EGBGB nos. 204 *et seq*.

transfer of title to the securities may be transferred by delivery of the certificate, the transfer of title to such negotiable registered securities is governed by the laws of the jurisdiction in which the certificates are physically located on completion of delivery.

If an instrument under its governing law qualifies as a claim transferable by assignment rather than as a bearer instrument or negotiable registered security (for example, *Schuldschein* loans or non-negotiable registered bonds governed by German law (*Namensschuldverschreibungen*)), the instrument may only be transferred by assignment of such claim.

Section 17a German Safe Custody Act (*Depotgesetz*, "**DepotG**")[106] does not follow the *lex rei (cartae) sitae* rule. In respect of "collectively held securities" which are transferable by booking into an account with constitutive legal effect for the benefit of the transferee, section 17a DepotG provides that the law governing the disposition of such securities (*Verfügung*, e.g. the transfer of title or creation of a security interest) is determined by reference to the location of the principal or branch office of the custodian bank (or, as the case may be, the central securities depository) making the account entry which directly results in the transfer of the *in rem* right to the transferee (*unmittelbar zugunsten des Verfügungsempfängers*). "Collectively held securities" are (i) securities which are kept in collective safe custody (*Sammelverwahrung*) by a central

[106] Section 17a DepotG has been enacted, among other things, to implement Article 9 para 2 SFD and provides that dispositions of securities or interests in securities held in collective safe custody, which are, with constitutive legal effect, entered into a register or booked in an account are governed by the laws of the country under whose supervision the register is kept in which such entry with constitutive legal effect is made directly *vis-à-vis* the person affected by the disposition (*Verfügungsempfänger*) or in which the main or branch office of the custodian which maintains the account and makes the account entry with constitutive legal effect *vis-à-vis* the person affected by the disposition is located. Securities are defined in section 1 para 1 DepotG to comprise shares, mining shares (*Kuxe*), interim certificates, interest, dividend and renewal coupons, bearer bonds or bonds transferable by endorsement as well as other securities provided that they are fungible (*vertretbar*). Non-negotiable registered bonds (*Namensschuldverschreibungen*) are also covered if they were issued to the name of a central securities depository. See *Dittrich*, in: Scherer, DepotG (2012), § 17a no. 36, proposing a wide interpretation of scope of application of section 17a DepotG in light of the European Directives on which section 17a DepotG was based.

securities depository, (ii) securities represented by a global certificate, or (iii) securities represented by a book entry for the benefit of a central securities depository (for example, certain German government bonds).

With respect to "dematerialised securities" which are transferable by book entry in a register with constitutive legal effect for the benefit of the transferee (*Buch-* or *Wertrechte*), section 17a DepotG provides that the law governing the transfer of such securities is determined by reference to the jurisdiction of the country under whose supervision the register is maintained making the account entry which directly results in the transfer of the *in rem* right to of the transferee. However, to date, certain questions relating to section 17a DepotG remain unresolved, and no court decisions exist in respect of the interpretation of such rule, in particular with respect to the meaning of "constitutive legal effect".[107] In particular, section 17a DepotG is only a conflict of laws provision and does not override any issues resulting from different national laws regarding the questions which instruments qualify as "securities" and which steps need to be taken to validly dispose of securities.

(iv) Outright title transfers

In our view, an outright title transfer to collateralise obligations can be validly made under German law. Parties are entitled to agree expressly that the secured party shall become the unrestricted title holder in respect of assets which are transferred serving as collateral. Such an outright title transfer arrangement does in our view not violate general principles of property laws. Furthermore, the concept of outright title transfers in order to collateralise obligations has been established under German law in section 1 para 17 KWG which refers to outright title

[107] See also *Einsele*, WM 2001, 2415, 2421 *et seq.*; *Reuschle*, RabelsZ 68 (2004), 687, 720; *Dittrich*, in: Scherer, DepotG (2012), § 17a nos. 51 *et seq.*

transfers[108] as one form of Financial Collateral.[109] While there are no German court decisions confirming the validity of an outright title transfer to collateralise an obligation, we take the view that an outright title transfer is valid under German law. In particular, in our view, an agreement on an outright title transfer to collateralise an obligation should not be regarded as a loan agreement, as in case of such an outright title transfer agreement the secured party is not obliged to return the collateral assets following a default of the security provider. Such agreement does therefore not provide for an obligation which is characteristic (*vertragstypische Leistungspflicht*) of a loan agreement, such as the repayment of the loan amount upon maturity.

(v) Recharacterisation

The BGB uses the term "recharacterisation" (*Umdeutung*) only in the context of the recharacterisation of a void legal transaction (*Rechtsgeschäft*) into another type of legal transaction, if the requirements for such other type of legal transaction are met and the entry into such other legal transaction reflects the intentions of the parties (section 140 BGB). However, where a transaction is valid, where German law applies, German courts seek to give effect to the true economic intentions of the parties as a matter of interpretation (*Auslegung*). As a result, under German law, a German court may construe a purported outright title transfer as a security interest e.g. in the form of a pledge or a security assignment, if it finds that a pledge or security assignment reflects the true economic intentions of the parties. If German law applies, German courts therefore generally recognise the validity of the agreement between the parties unless they find

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[108] The FCD uses the term "title transfer financial collateral arrangement". Pursuant to Article 2 para 1 lit (b) FCD "title transfer financial collateral arrangement" means an arrangement, including repurchase agreements, under which a collateral provider transfers full ownership of, or full entitlement to, financial collateral to a collateral taker for the purpose of securing or otherwise covering the performance of relevant financial obligations.

[109] *Kieninger*, in: Lwowski/Fischer/Gehrlein, Das Recht der Kreditsicherung, 10th ed. (2018), § 17 no. 118; *Behrends*, in: Zerey, Finanzderivate, 4th ed. (2016), § 6 nos. 65 *et seqq*.

that the form of security as agreed does not reflect the true economic intentions of the parties.

(vi) Renvoi

Under Article 20 Rome I, the application of the law of any country specified by Rome I generally means the application of the rules of law in force in that country other than its rules of conflict of laws (exclusion of *renvoi*).

Conversely, where the EGBGB applies, Article 4 para 1 sentence 1 EGBGB provides that any references of German law to the laws of another jurisdiction include the conflict of laws provisions of the other jurisdiction. If these conflict of laws provisions refer back to German law, German courts will accept such reference (*renvoi*) and apply German substantive law (Article 4 para 1 sentence 2 EGBGB). It is unclear whether the general rule of Article 4 para 1 EGBGB also applies to the more specific conflict of laws provision stipulated by section 17a DepotG or section 340 InsO.

To summarise, as matter of contract law, the choice of English law concerning the obligation to create security under the Opinion Documents will generally be recognised by the German courts.

Further, the choice of English law to govern the Deed of Charge is also generally recognised by the German courts if the Deed of Charge is granted over claims governed by English law and securities held in safe custody with LCH in England.

As German conflict of laws provisions refer to English law with respect to the creation of a security interest, no filing or registration requirements apply under German law in addition to any English law requirements to ensure that German law recognises the validity of the security interest as the recognition of the English law as the law governing the security interest will also extend to any filing or registration requirements. Further, there are no filing or registration requirements under German law which are merely based on the status of the Relevant Clearing Member having its place of establishment, incorporation or registration Germany.

(c) Enforcement of collateral in Insolvency Proceedings

While as a general matter, collateral can be enforced in accordance with its contractual terms and with the provisions of the relevant laws governing creation of the security (which may prevail over the contractual terms), mandatory restrictions which may affect the enforceability of security upon the opening of Insolvency Proceedings have to be observed.

(i) Rights to segregation and to separate satisfaction

LCH as creditor of a Relevant Clearing Member is entitled to enforce its rights in case of Insolvency Proceedings being commenced if it has a right to segregation (*Aussonderungsrecht*) from the insolvency estate with respect to an asset or if it has a right for separate satisfaction (*Absonderungsrecht*) within Insolvency Proceedings. If a security interest was validly created under a jurisdiction other than Germany and such security interest allows for segregation under German insolvency laws, it could be enforced without being affected by the opening of Insolvency Proceedings. If such security interest allowed for separate satisfaction, LCH as secured party may benefit from preferential treatment within Insolvency Proceedings but if such security interest further constituted Financial Collateral or secured claims under a System, the situation would even be comparable to a right to segregation.

We are not aware of any court decisions which provide guidance as to how German courts would determine whether and under which circumstances rights created under foreign law such as an English law charge would grant a right to segregation under section 47 InsO. Section 47 InsO not only refers to rights *in rem* but also to contractual claims that can give rise to a segregation right. However, the BGH held that in general only "absolute" rights *in rem* which can be asserted against any third party would be covered by section 47 InsO.[110] Only in exceptional cases would contractual claims entitle the creditor to a right of segregation. In any event, a creditor secured under an outright

[110] BGH VIZ 2004, 196, 197 *et seq*.

title transfer arrangement is entitled to a right of segregation if the title in the relevant collateral asset has been validly acquired and is not re-characterised.

It is disputed in German legal literature which law applies when determining the effects of Insolvency Proceedings on security over assets located outside Germany (i.e. to determine whether such secured party would be entitled to a right to segregation).

Article 8 Recast EUIR refers to assets which are situated within the territory of another EU member state at the time of the opening of insolvency proceedings and thereby refers to the territory of the EU member state which is not the EU member state in which the insolvency proceedings have been opened. Section 351 para 1 InsO provides that in the event a creditor has a right to segregation under German law for assets that are located in Germany at the opening of foreign insolvency proceedings, such segregation right will not be affected. Neither section 351 InsO nor any other provision under German insolvency law does, however, address the reverse scenario, i.e. that (German) Insolvency Proceedings are opened but third party rights exist with respect to non-German assets.

Generally, it is determined pursuant to the *lex fori concursus* (i.e. German insolvency law) which assets form part of the insolvency estate. As a consequence, certain legal commentators take the view that the *lex fori concursus* would also determine the question which consequences a certain right *in rem* would have in Insolvency Proceedings, e.g. whether it would entitle a third party to claim segregation of certain assets from the insolvency estate.[111] Other authors take the view that this should be subject to the *lex causae* (contract law) or *lex rei sitae* (property law), depending on the nature of the relevant asset.[112] If a court followed this view it would have to apply the *lex causae* or *lex rei sitae* either of the Deed of Charge or of the

[111] *Kindler*, in: Kindler/Nachmann: Handbuch Insolvenzrecht in Europa (7th ed. 2020 (as of July 2020), § 4 no. 51; *Ehret*, in: Braun, InsO, 8th ed. (2020), § 351 no. 1.

[112] *Kolmann/Keller*, in: Gottwald, Insolvenzrechts-Handbuch, 6th ed. (2020), § 131 nos. 25 *et seq.*; *Geimer*, Internationales Zivilprozessrecht, 7th ed. (2015), no. 3553.

relevant security interest. As the *lex causae* or *lex rei sitae* on the one side and the respective national insolvency laws on the other side could possibly lead to different results a court would have to decide on this query. A third group of legal commentators is of the view that the *lex fori concursus* and the *lex causae* should be combined so that with respect to an asset that is located in a country other than Germany, German insolvency law should be applicable but only to the extent that it does not restrict the creditor's right in a more restrictive way than it would be restricted by the insolvency law identified by way of the process according to the first view.[113]

We take the view that the treatment of assets located outside Germany upon the opening of Insolvency Proceedings should be determined in accordance with the rules of the InsO but the characterisation of any rights in relation to such assets should be determined in accordance with the governing law of these rights. A court would therefore have to determine, on the basis of the specific characteristics of the relevant security interest under its governing law (as determined under German conflict of laws principles), whether for purposes of the InsO a security interest benefits from preferential treatment in the form of segregation or preferred satisfaction or whether it would rank *pari passu* with all other unsecured creditors as its specific characteristics were not comparable to a security interest benefiting from preferential treatment in the form of segregation or preferred satisfaction.

(ii) Enforcement of rights to separate satisfaction

Where a security interest provides the secured party with a right to separate satisfaction rather than with a right for segregation, a distinction generally has to be drawn between such security interests which may be enforced by the secured party and security interests which are enforced by the Insolvency Administrator. Where section 166 paras 1 and 2 InsO applies, a security interest would be enforced by the Insolvency Administrator (e.g. in respect of movable goods in the

[113] See *Reinhart*, in: Münchener Kommentar InsO, 4th ed. (2020), § 335 InsO no. 60 for an overview.

possession of the Insolvency Administrator[114] or claims assigned for security purposes). Section 166 para 1 InsO applies to security interests over moveables where the Insolvency Administrator has possession. The Insolvency Administrator would in such case be obliged to transfer any proceeds realised after deduction of a lump sum fee for the determination of the existence of the security interest amounting to 4 per cent (*Feststellungskosten*) plus up to 5 per cent (in certain cases even more than 5 per cent) for any cost incurred in the context of the realisation of the security interest (*Verwertungskosten*) (plus applicable VAT on the proceeds of realisation to the creditor).

(iii) Exemptions for Systems and Financial Collateral

A secured party entitled to separate satisfaction may in any event realise security interests which collateralise claims under a System as well as security interests which qualify as Financial Collateral itself even within Insolvency Proceedings (section 166 para 3 nos. 1 and 3 InsO). If the preconditions for these exemptions are met, they apply irrespective of the specific type of the foreign security interest. Please refer to paragraph 3.2.1(h) with respect to the exemptions relating to Systems and with respect to Financial Collateral please refer to paragraph 3.2.1(g). Furthermore, a secured party may enforce (German law) pledges over contractual claims itself (section 173 para 1 InsO).

The security interest created under the Deed of Charge qualifies as Financial Collateral if (i) the Chargor is an eligible security provider[115], (ii) the security interest is created over an eligible type of asset and (iii) the security interest qualifies as *in rem* security arrangement or outright title transfer.

Cash deposits (*Barguthaben*) or cash amounts (*Geldbeträge*) and securities (*Wertpapiere*) are expressly mentioned as eligible assets. Cash deposits are amounts of money credited to an

[114] The BGH has ruled that the Insolvency Administrator does not have possession within the meaning of section 166 para 1 InsO in respect of pledged shares held in collective safe custody by a central securities depository where the debtor can no longer exercise membership rights due to the transfer of such rights to a trustee (BGH ZIP 2015, 2286).

[115] As regards LCH's status as eligible secured party see paragraph 3.2.1(g).

account or equivalent monetary claims. Accordingly, to the extent that any cash amounts are deposited into cash accounts, these would qualify as eligible assets. However, not every claim to demand a payment qualifies as such a monetary claim or cash amount. Only assets expressly listed in section 1 para 17 KWG qualify as eligible assets.

Further, the relevant security interest must qualify as *in rem* security arrangement or outright title transfer. In this respect, Article 2 para 1 lit. c) FCD defines a security financial collateral arrangement as an arrangement under which a collateral provider provides financial collateral by way of security to or in favour of a collateral taker, and where the full or qualified ownership of, or full entitlement to, the financial collateral remains with the collateral provider when the security right is established. If, as a matter of English law, on which we do not opine, the charge under the Deed of Charge qualified as such security financial collateral arrangement, and a court came to the view that, by applying the doctrine of transposition, the charge could be seen to be sufficiently similar to a German law type of security interests over cash or movables (such as a pledge or a security assignment/security transfer, which constitute *in rem* security arrangements under German law), the Deed of Charge would constitute Financial Collateral. We are however not aware of any court decisions confirming this view. To the extent that the security provider is entitled to dispose over collateral (at least in cases which do not relate to a right to substitution or withdrawal of excess collateral), which under the Deed of Charge is a question of English law on which we do not opine, there would be a risk that a court could take the view that the qualification as Financial Collateral is endangered (see paragraph 3.2.1(g)).

If LCH qualifies as a System, the effects of Insolvency Proceedings on the rights and obligations of participants in a System within the meaning of section 1 para 16 KWG would be governed by the laws of the state which applies to that System rather than being subject to the provisions of the InsO, please see as to the effects and scope of application of section 340 para 3 InsO; paragraph 3.2.3(b)(iii).

3.2.3 *Would LCH have the right to take the actions provided for 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.*

To answer this question, we first summarise our understanding of the actions provided in Rules 3, 5, 6 and 8 of the Default Rules followed by an analysis of the respective restrictions on such actions in Insolvency Proceedings.

Pursuant to Rule 3 of the Default Rules, any steps taken under Rule 6 shall serve the purpose (i) to discharge all the Clearing Member's rights and liabilities under or in respect of all Contracts to which it is party or upon which it is or may be liable and (ii) to complete the process set out in Rule 8. Accordingly, Rule 6 entitles LCH to terminate Contracts entered into with the Relevant Clearing Member, and we understand that Contracts which are covered by Rule 6 may or may not be automatically terminated in accordance with Rule 5 of the Default Rules (stipulating certain events which give LCH the right to take the actions as contemplated by Rule 6). Furthermore, under Rule 6 LCH may also take other steps, including incurring new and additional obligations of such defaulting Relevant Clearing Member for the purpose of settling or liquidating any open Contracts (for example by way of entering into opposite Contracts or by exercising any options on behalf of the defaulting Relevant Clearing Member). Rule 6 also enables LCH to realise security granted to LCH by the defaulting Relevant Clearing Member.

In a second step, Rule 8 as we understand, provides for a process to be completed by LCH to determine net amounts remaining payable between LCH and the defaulting Relevant Clearing Member, i.e. LCH is permitted to aggregate, i.e. set off any sums payable by and to a defaulting Relevant Clearing Member with respect to each "kind of account" (as such term is defined in Rule 11 (b) of the Default Rules, i.e. each separated client account and the Relevant Clearing Member's own account) including any cash collateral.

In our view, the termination rights under Rules 3, 5 and 6, and the set-off under Rule 8 constitute close-out netting provisions (in this context together the "**Netting Provisions**") and therefore, where we refer in the following to the German law treatment of netting, our reasoning is applicable to these provisions. Contractual close-out netting provisions provide for a method of reducing the parties' exposure by terminating outstanding transactions, calculating their values and determining compensation payments for all outstanding transactions that are subsequently netted against each other. Accordingly, they are subject to both the laws applicable to early termination and to set-off.

Where the event of default is not related to the insolvency of the Defaulter[116], the conflict of laws analysis given under paragraph 3.1.4(a) would apply, both in respect of the agreement on a deemed or specified liquidation and the calculation of the liquidation amount. Pursuant to Article 12 para 1 lit (d) Rome I, the law applicable to a contract by virtue of Rome I shall govern, amongst other things, the various ways of extinguishing obligations. Agreements on termination rights are therefore covered by the parties' rights to choose the law governing the Rulebook (above, paragraph 3.1.4(a)). The contractual validity under contract law of the right of LCH to declare Contracts to be terminated, would therefore be a matter of the laws of England.

Article 17 Rome I provides that where the right to set-off is not agreed by the parties, set-off shall be governed by the law applicable to the claim against which the right to set-off is asserted. Given the clear wording of Article 17 Rome I, any contractual agreements relating to set-off of netting of obligations are outside the scope of Article 17 Rome I and the parties may therefore agree on set-off or netting agreements such as the Netting Provisions in accordance with Article 3 para 1 Rome I. The validity under contract law of the agreement on the set-off of all the reciprocal payment obligations of the Defaulter and LCH, so that these payment obligations will be deemed satisfied, in whole or in part, to the extent of the set-off would thus have to be assessed in accordance with the laws of England.

[116] A non-insolvency related termination event is a termination event that is based on the occurrence of a situation which bears no specific relation to any reason for the opening of Insolvency Proceedings, but relates, for example, to the counterparty's default or other types of breach of contract (BGH WM 2013, 274).

The question whether the Netting Provisions are enforceable following an insolvency-related event of default[117] raises several legal issues.

(a) Conflict of laws provisions as regards netting and set-off under the Recast EUIR

With respect to netting under German international insolvency law within the scope of the Recast EUIR the following applies:

(i) Scope of the *lex fori concursus* rule (Article 7 Recast EUIR)

When applicable, Article 7 Recast EUIR provides that the law applicable to insolvency proceedings and their effects shall be the law of the EU member state in which the proceedings are opened. Insolvency proceedings are opened in the jurisdiction where the centre of main interests of the Insolvent Party is located except where there is another, more specific, provision within the Recast EUIR itself – subject to any secondary proceedings. Secondary proceedings are governed by the law of the EU member state (other than Denmark) in which they are opened (Articles 3 para 2, 35 Recast EUIR).

Cases where rights may be immunised from the effects of insolvency law are, for example, "*rights in rem*" over assets outside the jurisdiction where the insolvency proceedings are conducted (Article 8 Recast EUIR) and rights of set-off permitted by the law applicable to the insolvent debtor's claim (Article 9 Recast EUIR).

(ii) Conflict of laws rule regarding insolvency set-off

Under the Recast EUIR set-off is permitted in each of the two following situations:

(A) if it is permitted under the insolvency laws[118] of the jurisdiction in which insolvency proceedings have been

[117] An insolvency related termination event means a termination event which is linked to a cessation of payments, the opening of Insolvency Proceedings or the filing of an application for the opening of Insolvency Proceedings (BGH WM 2013, 274).

[118] According to many legal commentators in Germany (*Reinhart*, in: Münchener Kommentar InsO, 3rd ed. (2016), Article 4 EuInsVO 2000 no. 3; *Haß/Herweg*, in: Haß *et al*., EU-Insolvenzverordnung (2005), Article

opened in relation to the insolvent debtor (Article 7 para 2 lit (d) Recast EUIR) or

(B) if it is permitted by the law applicable to the insolvent debtor's claim (Article 9 para 1 Recast EUIR).

Article 9 para 1 Recast EUIR establishes an insolvency conflict of laws rule regarding insolvency set-off as an exception to the *lex fori concursus* rule as set forth by Article 7 para 1 Recast EUIR. In relation to (1), the laws of Germany would be applicable in the case of Insolvency Proceedings being opened by a court in Germany.[119] In relation to the situation mentioned under (2), set-off will be allowed if it is permitted under the laws governing the Rulebook and the relevant Contracts.

In our view, close-out netting arrangements do not fall within the scope of application of Article 9 para 1 Recast EUIR. The wording of Article 9 para 1 Recast EUIR supports this interpretation as the term "set-off" only covers one element of close-out netting but does not refer to other integral parts such as the early termination (closing-out) of transactions or the valuation and conversion of the terminated transactions into claims which are eligible for set-off. While it has been argued with respect to Article 6 para 1 EUIR (which corresponds to Article 9 para 1 Recast EUIR) that this provision should be construed broadly to include close-out netting arrangements to enable financial market participants to choose the insolvency law applicable to close-out netting,[120] Recital 71 Recast EUIR in

4 EuInsVO 2000 no. 32) the EUIR (and, hence, also the Recast EUIR) only concerns set-off restrictions that stem from the insolvency law of the jurisdiction in which insolvency proceedings have been opened. The scope of the *lex fori concursus* thus would be limited to such laws. The general legal requirements relating to set-off (e.g. in Germany sections 387 *et seq*. BGB), however, are determined according to the generally applicable conflict of law rules.

119 This includes insolvency law, e.g. in Germany sections 94 *et seq.* InsO (*Kindler*, in: Münchener Kommentar BGB, 8th ed. (2021), § 340 InsO no. 8; *Gruber*, in: Haß *et al.*, EU-Insolvenzverordnung (2005), Article 6 EuInsVO 2000 no. 9; *Reinhart*, in: Münchener Kommentar InsO, 3rd ed. (2016), Article 6 EuInsVO 2000 no. 9).

120 See European Financial Markets Lawyers Group, Protection for Bilateral Insolvency Set-off and Netting Agreements under EC Law, A report by the European Financial Market Lawyers Group (EFMLG), October 2004, nos. 72 *et seq*.

connection with Article 12 Recast EUIR clarify that the European legislator distinguishes between set-off and netting agreements and that the later shall only be exempted from the *lex fori concursus* rule of Article 7 para 1 Recast EUIR if agreed in the context of a payment or securities settlement system. Moreover, the European legislator uses the terms set-off and netting agreements differently in other relevant European legal acts as well.[121] Therefore, we take the view that Article 9 para 1 Recast EUIR does not refer to close-out netting arrangements.

(iii) Financial markets under the Recast EUIR

Pursuant to Article 12 para 1 Recast EUIR, the effects of insolvency proceedings on the rights and obligations of the parties to a payment or settlement system or to a financial market are governed solely by the law of the EU member state applicable to that system or market. As the Rulebook will continue to be governed by English law Article 12 Recast EUIR would not be applicable.

(iv) Effects of Article 9 para 2 Recast EUIR

Pursuant to Article 7 para 2 lit (m) Recast EUIR the law of the EU member state opening the insolvency proceedings (*lex fori concursus*) determines the rules relating to the voidness, voidability or unenforceability of legal acts which are detrimental to all creditors. Article 9 para 2 Recast EUIR provides that the protection for set-off pursuant to Article 9 para 1 Recast EUIR does not preclude actions for voidness, voidability or unenforceability as referred to in Article 7 para 2 lit (m) Recast EUIR. Consequently, Article 9 para 2 Recast EUIR preserves the ability of the *lex fori concursus* to declare the provision void despite the protection in Article 9 para 1 Recast EUIR.

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[121] See also the proposal of the European Commission dated 12 December 2012 (COM (2012) 744 final), which intended to include Article 6a covering "netting arrangements". However, Article 6a has not been included in the final version of the Recast EUIR. See also: *Reinhart*, in: Münchener Kommentar InsO, 3rd ed. (2016), Article 9 EuInsVO, no. 2 *et seqq*.

(b) Conflict of laws provisions as regards netting and set-off under the InsO

With respect to netting under German international insolvency law outside the scope of the Recast EUIR the following applies:

(i) Principles of German international insolvency law

Under German international insolvency laws, section 335 InsO provides that insolvency proceedings and their effects are, in general, governed by the laws of the jurisdiction in which the proceedings have been opened. However, the InsO provides for some exceptions to this principle.

With respect to insolvency proceedings instituted in a jurisdiction other than Germany, section 351 InsO provides that rights *in rem* of creditors or third parties in assets of the insolvent estate are not affected by the foreign proceedings provided that the relevant assets are situated in Germany at the time of the opening of the foreign proceedings and such right *in rem* entitles the creditor or, as the case may be, the third party to segregation of the relevant asset from the insolvency estate (*Aussonderung*) or separate satisfaction (*Absonderung*).

Section 338 InsO provides that any right to declare a set-off is not affected by the opening of Insolvency Proceedings, provided that such right exists in accordance with the law governing the relevant claim of the Insolvent Party at the time the Insolvency Proceedings are instituted. Section 339 InsO provides that the validity of specific legal acts may be challenged if the requirements for doing this in insolvency proceedings are met in accordance with the law governing the insolvency proceedings, unless the party whose acts are to be challenged provides conclusive evidence that the relevant act is governed by the laws of another state and cannot be challenged thereunder.

(ii) Effect of section 340 para 2 InsO on the Netting Provisions

Where the Recast EUIR does not apply, section 340 para 2 InsO provides for an insolvency conflict of laws rule for "netting agreements". According to the BGH the substantive insolvency

laws of the jurisdiction the laws of which have been chosen by the parties to govern the relevant netting agreement apply.[122]

Even though section 340 para 2 InsO does not provide any guidance on the interpretation of the term "netting agreement", the legislative history reveals that master agreements within the meaning of section 104 para 3 sentence 1 InsO fall within the scope of section 340 para 2 InsO.[123] Pursuant to the BGH, master agreements which contain netting agreements such as financial market specific offsetting provisions (*finanzmarktspezifische Verrechnungsformen*), such as the German law governed Master Agreement for Financial Derivatives Transactions (*Rahmenvertrag für Finanztermingeschäfte*) fall within the scope of section 340 para 2 InsO.[124] When analysing what constitutes a netting agreement, the BGH emphasised the

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[122] Before the 9 June 2016 decision of the BGH, it was not entirely clear to which set off rules the wording "law of the country which governs such agreements" refers. Basically, section 340 para 2 InsO could refer to (i) the substantive insolvency laws of the jurisdiction that has been chosen by the parties to govern the relevant agreement (*Tashiro*, in: Braun, Insolvenzordnung, 8th ed. (2020) § 340 nos. 3 and 4; *Jahn/Fried*, in: Münchener Kommentar InsO, 4th ed. (2020) § 340 InsO nos. 6 *et seq*.), (ii) the substantive contract law of the jurisdiction that has been chosen by the parties to govern the relevant agreement (*Kindler*, in: Münchener Kommentar BGB, 8th ed. (2021) § 340 InsO no. 5 (*lex causae*); *Swierczok*, in: Heidelberger Kommentar InsO, 10th ed. (2020), § 340 InsO nos. 4 *et seqq*.) or (iii) directly to the terms of the relevant agreement without any regard to the substantive insolvency or contract laws (this interpretation is supported by *Schneider*, in: Kohler/Obermüller/Wittig, Kapitalmarkt – Recht und Praxis, Gedächtnisschrift für Ulrich Bosch (2006), p. 211). In our view, this is now settled, as the BGH has applied substantive insolvency laws when referring to section 340 para 2 InsO (BGH WM 2016, 1168, 1172).

[123] BT-Drucksache 15/16, p. 20; see also *Kolmann/Keller*, in: Gottwald, Insolvenzrechts-Handbuch, 6th ed. (2020), §131 no. 85. Section 340 para 2 InsO implements Article 25 WUD into German law. Article 25 WUD (addressing netting agreements (*Saldierungsvereinbarungen*)) has been amended by Article 117 BRRD and should as from now be construed as referring to netting arrangements within the meaning of Article 2 para 1 no. 98 BRRD. Even though the wording of Article 25 WUD has been amended the wording of section 340 InsO was left unchanged but presumably was considered sufficient to address the change of the WUD. However, we construe the scope of section 340 InsO still on its wording rather than based on the changes made to Article 25 WUD. While under the relevant applicable requirements a direct application of a EU Directive or at least an interpretation of national law serving the purpose of implementing a specific EU Directive in conformity with EU law (*richtlinienkonforme Auslegung)* is generally possible (see *Ruffert*, in: Calliess/Ruffert, EUV/AEUV, 5th ed. 2016, Art. 288 AEUV no. 77), we do not think that there is sufficient evidence for meeting these requirements.

[124] BGH WM 2016, 1168, 1172.

"balancing" or "netting" (*Saldierung*) of payment streams without referring to any other relevant features.[125]

It is unclear whether section 340 para 2 InsO applies to rulebooks or clearing conditions of central counterparties in a clearing context. Section 104 para 3 sentence 1 InsO refers to master agreements and the rules of a central counterparty. Furthermore, we understand that clearing of Contracts under the Rulebook results in bilateral contractual relationships between LCH and a Relevant Clearing Member as well as between a Relevant Clearing Member and a client. However, irrespective of whether or not section 340 para 2 InsO can be construed in light of section 104 para 3 sentence 1 InsO, the Rulebook would likely not qualify for treatment under section 340 para 2 InsO as section 104 para 3 sentence 1 InsO requires that the relevant transactions covered by the rules of the central counterparty can only be terminated in their entirety, which is not the case with respect to the Rulebook as we understand.

(iii) Effect of section 340 para 3 InsO on the Netting Provisions

Section 340 para 3 InsO provides that the effects of insolvency proceedings on the rights and obligations of participants in a System within the meaning of section 1 para 16 KWG are governed by the laws of the state which applies to that System.

We would construe section 340 para 3 InsO so as to refer to the substantive insolvency laws of the country the laws of which govern the relevant System given its wording, context and the legislator's intention to provide clarity on the applicable insolvency laws.[126] This would also be in line with the decision of 9 June 2016 of the BGH relating to section 340 para 2 InsO as set out above.[127]

To the extent LCH qualifies as a System, (paragraph 3.2.1(h)) section 340 para 3 InsO will apply. Should both section

[125] BGH WM 2016, 1168, 1172.

[126] See BT-Drucksache 15/16, p. 20.

[127] BGH WM 2016, 1168, 1172.

340 para 2 InsO and section 340 para 3 InsO apply, we believe that section 340 para 3 InsO should prevail over section 340 para 2 InsO as section 340 para 3 InsO is more specific than section 340 para 2 InsO.[128]

(c) Close-out netting under the InsO

However, should LCH not qualify as a System and if also no other conflict of laws provisions provide for the application of English substantive insolvency law with respect to the effects of the opening of Insolvency Proceedings over the assets of a Relevant Clearing Member, the following principles of substantive German law apply.

(i) Protection of the Selection Right

Following the opening of Insolvency Proceedings, mutual contracts[129] which have not, or not (yet) fully, been performed (*nicht oder nicht vollständig erfüllt*) by either party ("**Executory Contracts**") and which have not been effectively terminated prior to such opening of Insolvency Proceedings are, pursuant to section 103 InsO, subject to the Insolvency Administrator's "cherry picking" right, i.e. the right to decide whether or not to enforce Executory Contracts ("**Selection Right**").[130]

[128] This is, however, only relevant where the netting agreement and the System are governed by different laws which is not the case with respect to the Rulebook.

[129] Mutual contracts are contracts giving rise to mutual rights and obligations (*gegenseitige Verträge*) within the meaning of sections 320 *et. seq*. BGB, whereby each of the parties only agrees to perform its obligations in exchange for the other party performing its obligation (*Huber*, in: Münchener Kommentar InsO, 4th ed. (2019), § 103 InsO no. 55).

[130] The opening of Insolvency Proceedings does not lead to the termination of the contractual obligation to perform. Rather, the opening of Insolvency Proceedings only affects the enforceability of the respective claims since both parties to a contract may raise the objection of non-performance of a contract (BGH ZIP 2002, 1093, 1095). Therefore, neither the opening of Insolvency Proceedings nor the decision of the Insolvency Administrator result directly in a termination of the contractual agreement.

An English translation of section 103 InsO reads as follows:

"Section 103

Selection right by the insolvency administrator

(1) If a mutual contract was not or not fully performed by the debtor and the other party at the date when the insolvency proceedings were opened (executory contract), the insolvency administrator may perform such contract in place of the debtor and claim performance by the other party.

(2) If the insolvency administrator refuses to perform such contract the other party is entitled to assert its claims for non-performance only as an insolvency creditor. If the other party requires the insolvency administrator to decide whether it chooses performance or non-performance the insolvency administrator is obliged to state his intention to claim performance without undue delay. If the insolvency administrator does not give his statement he may no longer insist on performance."

In the event that the Insolvency Administrator refuses to perform a relevant contractual obligation the contractual agreement is terminated and the Solvent Party may assert claims arising from non-performance only as a creditor in the Insolvency Proceedings. Such claims rank *pari passu* with the claims of all other unsecured creditors.

Section 119 InsO provides that agreements excluding or limiting the application of sections 103 to 118 InsO in advance are invalid and therefore protects the Insolvency Administrator's Selection Right. As an early termination following the exercise of the termination right under the Netting Provisions restricts the Selection Right, it may be invalid if it violates sections 103, 119 InsO. In the following we analyse the scope of sections 103, 119 InsO with respect to a termination under the Netting Provisions and any potential exceptions.

Based on its wording, section 119 InsO only applies after the opening of Insolvency Proceedings. However, based on the

purpose of such section to protect the rights under sections 103 to 118 InsO, the BGH held that section 119 InsO applies from the point in time in which, based on a valid application for the opening of Insolvency Proceedings, such opening of Insolvency Proceedings is to be seriously expected (*mit der Eröffnung eines Insolvenzverfahrens ernsthaft zu rechnen ist*).[131] Any contractual early termination right based on insolvency related events is therefore void if the termination is triggered resulting from the occurrence of such event.[132]

Whereas, according to the BGH, "non-insolvency related" termination provisions are not intended to "undermine" the Selection Right and therefore non-insolvency related termination provisions would generally not be covered by section 119 InsO, the validity of contractually stipulated termination rights that are based on insolvency related events depends on whether or not the respective agreement is deemed as an exclusion or limitation of the application of the Selection Right. However, the BGH also confirmed that the Selection Right cannot be undermined where there is an exemption from the Selection Right.

(ii) Exemption from the Insolvency Administrator's Selection Right

Section 104 InsO provides for an exemption from the Insolvency Administrator's Selection Right for fixed date transactions (*Fixgeschäfte*) and financial transactions (*Finanzleistungen*). To the extent section 104 InsO applies, it overrides the Insolvency Administrator's Selection Right under section 103 InsO.

The current version of section 104 InsO entered into force on 29 December 2016 and has been changed significantly compared to the previously applicable version. While these changes are, to some extent, intended to adapt the wording to market developments such as product innovation, they also have to be regarded as a response to the BGH decision of 15 November

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131 BGH WM 2013, 274.

132 BGH WM 2013, 274, 275 *et seq*. (relating to a contract for the supply of energy), confirmed by BGH WM 2016, 1168, 1173 also in respect of other contracts; see also *Obermüller*, ZInsO 2013, 476, 480 *et seq*.

2012 and, in particular to the BGH decision of 9 June 2016.[133] Understanding the purpose of the changes and the exemptions created thereby for contractual close-out netting arrangements is relevant for assessing to what extent the limits set by the BGH need still to be observed.

On 9 June 2016[134] the BGH did not explicitly decide whether or not an insolvency related contractual early termination right triggered upon the filing of an application for the opening of Insolvency Proceedings or any other relevant point in time before the opening of Insolvency Proceedings was void *per se*.[135] Rather, the BGH explained in its reasoning that the Selection Right cannot be "undermined" by such contractual termination right as there is no Selection Right where section 104 InsO applies.[136] However, in its decision of 9 June 2016, the BGH went beyond this statement by holding that, if parties to a transaction governed by German law entered into a netting agreement (in the reasoning referred to as "*Abrechnungsvereinbarung*") for the event of an insolvency which is contradictory to section 104 InsO (in the version applicable before 10 June 2016), the netting agreement is void in this respect and the provisions of section 104 InsO are directly applicable. The BGH has explicitly ruled that section 104 InsO prevails over contractual arrangements. A contractually agreed early termination of a transaction covered by section 104 InsO based on the filing for the opening of Insolvency Proceedings was held to be valid, as such early termination right *per se* does not modify the legal consequences under section 104 InsO, but the valuation method must not deviate from the method set forth in, and also the point in time relevant for the valuation must not deviate from, section 104 InsO.[137] As a consequence it follows from the BGH's decision that, if the contractually agreed valuation method or the timing of the valuation are not based on the method, and timing

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133 BT-Drucksache 18/9983, p. 8, 10.

134 BGH WM 2016, 1168.

135 With respect to the 2012 decision, please refer to *Obermüller*, ZInsO 2013, 476.

136 BGH WM 2016, 1168, 1173.

137 BGH WM 2016, 1168, 1173 *et seq*.

stipulated in the version of section 104 InsO in force before 10 June 2016 then such agreement is void under section 119 InsO. Based on the changes made to section 104 Inso after the BGH's decision this strict interpretation can in our view no longer be upheld.

Referring to the BGH decision of 9 June 2016, the legislative reasoning given for the changes to section 104 InsO clarifies that contractual close-out netting provisions are enforceable in insolvency.[138] The legislative reasoning also clarifies that parties may enter into contractual agreements which deviate from the statutory netting mechanism. However, the relevant contractual agreement must not deviate from the fundamental principles of the statutory provision which is to remedy the uncertainties that would arise from the application of the Selection Right to transactions that fall within the scope of section 104 InsO. While section 119 InsO was not amended, we construe the legislative reasoning to imply that section 119 InsO needs to be construed in light of the changes made to section 104 InsO. In any event, there is no scope for the Selection Right under section 103 InsO to the extent section 104 InsO applies and, hence, there is also no room for section 119 InsO in such case.

(iii) Scope and analysis of section 104 InsO

Upon the opening of Insolvency Proceedings, section 104 InsO provides for a mandatory automatic termination of those transactions which fall within its scope. If the relevant date for early termination falls after the opening of Insolvency Proceedings the provisions of section 104 InsO would govern the close-out netting of those transactions which fall within its scope. Section 104 InsO would have no effect on those transactions which fall outside its scope and the analysis described above in paragraph 3.2.3(c)(i) would apply thereto, i.e. section 103 InsO would apply to transactions if they qualify as Executory

[138] BT-Drucksache 18/9983, p. 8, 9, 10, 13.

Contracts and the Insolvency Administrator is entitled to exercise the Selection Right.

As mentioned, the currently applicable version of section 104 InsO entered into force on 29 December 2016 and applies pursuant to Article 5 para 1 of the Third Law Amending the Insolvency Code and the Introductory Act to the Code of Civil Procedure (*Drittes Gesetz zur Änderung der Insolvenzordnung und zur Änderung des Gesetzes betreffend die Einführung der Zivilprozessordnung*, "**Third Insolvency Code Amendment Act**")[139] to all Insolvency Proceedings opened on or after such date. An English translation of Section 104 InsO in the version entered into force on 29 December 2016 is attached as Appendix A hereto. All references in this Opinion to section 104 InsO are to such version, unless otherwise indicated.

Section 104 para 1 sentence 1 InsO covers fixed date transactions (*Fixgeschäfte*) on commodities (*Waren*) and section 104 para 1 sentence 2 InsO covers financial transactions (*Finanzleistungen*), which are further defined in sentence 3. Section 104 para 2 InsO provides for a calculation method for the claim for non-performance following the early termination of transactions by section 104 InsO.[140]

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[139] BGBl. 2016 I, p. 3147.

[140] It is unclear whether it is required that, given that section 104 InsO is a special rule to section 103 InsO, a transaction must qualify as an Executory Contract to fall within its scope (affirming this view with respect to section 104 InsO as in force prior to 10 June 2016, *Bosch*, Kölner Schrift zur Insolvenzordnung, 2nd ed. (1999), p. 1018 no. 33). Unlike the previous version of the provision (section 104 para 2 sentence 3 InsO as in force prior to 10 June 2016), section 104 InsO in its amended form no longer refers to section 103 InsO. While systematically section 104 InsO is part of the same chapter of the InsO as section 103 InsO, other provisions in this chapter do not require Executory Contracts (see sections 115 and 108 para 2 InsO, in respect of the discussions in legal literature see *Hoffmann*, in: Münchener Kommentar InsO, 4th ed. (2019), § 108 InsO no. 142. The purpose of section 104 InsO (also in its previous version) is the protection of the counterparty from uncertainties resulting from the Insolvency Administrator's Selection Right (see BT-Drucksache 12/2443, p. 145 and BT-Drucksache 18/9983, p. 19). It could therefore be argued that the application of section 104 InsO requires an Executory Contract within the meaning of section 103 InsO, as otherwise there would be no need for an exemption. However, some of the transactions enumerated in section 104 para 1 sentence 3 InsO (such as certain options) have already been fulfilled by one of the parties and others (such as financial collateral and contracts for difference) do not constitute Executory Contracts (some of them are not even mutual contracts) (see *Balthasar*, in: Nerlich/Römermann, InsO, 41st update (as of June 2020), § 104 InsO no. 31). According to the legislative reasoning to the version of section 104 InsO which

Section 104 para 3 InsO expressly recognises "single agreement clauses" with respect to transactions which have been entered into under a master agreement or the rules of a central counterparty (see paragraph 3.2.3(d) below). Section 104 para 4 sentence 1 InsO clarifies that parties to a contract may agree on terms deviating from the statutory netting provision as long as these are compatible with the fundamental principles applicable for the relevant statutory requirement which is being amended and sentence 2 gives examples of permitted deviations.

To summarise, any automatic termination by virtue of section 104 InsO results in a claim for non-performance calculated on the basis of market or exchange prices subject to section 104 para 2 InsO. The claim for non-performance would, irrespective of the law governing the relevant transaction or agreement, be governed by German law and would generally rank *pari passu* with claims of all other unsecured creditors. The claim for non-performance is expressed in Euro and may be subject to set-off.[141]

(iv) Fixed date transactions (*Fixgeschäfte*)

Section 104 para 1 sentence 1 InsO applies to fixed date transactions (*Fixgeschäfte*) on tangible goods with a market or exchange price only. Fixed date transactions are transactions where performance has to occur at a specific point of time because the creditor puts special emphasis on the timeliness of the performance.

(v) Financial transactions within the meaning of section 104 para 1 sentences 2, 3 InsO

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entered into force on 29 December 2016, however, rather than the transaction fulfilling the formal requirement of an "Executory Contract", it should be decisive whether the market risks to which the transaction is subject should be captured by the scope of protection awarded by section 104 InsO to the parties, and, in particular, the Solvent Party (BT-Drucksache 18/9983, p. 19). See also *Fried* in: Münchener Kommentar InsO, 4th ed. (2019), § 104 InsO no. 46 *et seq*.

[141] Section 104 InsO does in our view not include any set-off but, by transforming the former payment and delivery claims into an Euro denominated payment claim, provides a basis for set-off (subject to the general set-off restrictions under contract and insolvency law, as applicable), please also refer to footnote 169 below.

Section 104 para 1 sentence 2 InsO applies to financial transactions (*Finanzleistungen*) as further defined in section 104 para 1 sentence 3 InsO. Financial transactions are transactions which have a market or exchange price, and for which a particular time or period was agreed which only occurs or expires after the opening of insolvency proceedings.[142] Whereas section 104 InsO does not define what would constitute a market or exchange price, in our view, the interpretation of this requirement can be based on generally applicable principles of civil law such as section 385 BGB.[143]

Section 104 para 1 sentence 3 InsO gives examples of financial transactions. The wording of section 104 para 1 sentence 3 InsO indicates that the enumeration of financial transactions is not conclusive (indicated by the words "in particular"). The legislative reasoning also shows that the words "in particular" are intended to address any future developments with respect to financial transactions.[144] Furthermore, based on the purpose of section 104 InsO, which is to limit the Insolvency Administrator's ability to speculate on price or market developments with respect to volatile instruments by not deciding whether to assume or reject any obligations subject to the Selection Right,[145] a court may accept that transactions showing comparable features to the enumerated financial

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[142] Based on its wording, undated transactions (e.g. transactions which are due upon the giving of notice or transactions with an undetermined period of time) are outside the scope of application of section 104 para 1 sentence 2 InsO.

[143] Pursuant to section 385 BGB, which is a generally applicable provision under civil law, a market or exchange price is given if at the relevant place the relevant assets are traded to an extent which allows the determination of a market or exchange price on the basis of the transactions which have taken place. A market price is available where based on the frequency of transactions an average price can be determined. According to the reasoning of the German legislator to the version of section 104 InsO applicable before 10 June 2016 (see BT-Drucksache 12/7302, p. 168), the term "market or exchange price" within the meaning of section 104 para 1 sentence 2 InsO needs to be construed broadly. With respect to the version of section 104 InsO currently in force the references to market and exchange price in the legislative reasoning are focusing on the calculation methods under section 104 para 2 InsO. The BGH has referred to the possibility of entering into replacement transactions, BGH WM 2016, 1168, 1174.

[144] BT-Drucksache 18/9983, p. 11, 18.

[145] BT-Drucksache 18/9983, p. 9. This was already the case with respect to the version of section 104 InsO applicable before 10 June 2016; BT-Drucksache 12/2443, p. 145; BT-Drucksache 12/7302, p. 167.

transactions and in respect of which the same concerns may arise which the legislator has raised to justify the exemptions from the Selection Right under section 104 InsO, could be covered by section 104 para 1 sentence 2 InsO even if not explicitly mentioned.[146] In this respect the legislative reasoning clarifies that interests of the Solvent Party and the interests of the insolvency estate need to be balanced.[147]

Financial transactions are transactions on the delivery of precious metals (no. 1), the delivery of financial instruments or comparable rights, except where there is an intention to acquire an interest in another enterprise with the aim of establishing a long-term relationship with that enterprise (no. 2), payments of money which are to be made in a foreign currency or in a mathematical unit, or the amounts of which are calculated, directly or indirectly by referencing to the exchange rate of a foreign currency or a unit of account, to the interest rate for borrowings or to the price of other goods (*Güter*) or services (no. 3), deliveries and payments from derivative financial instruments except where there is an intention to acquire an interest in another enterprise with the aim of establishing a long-term relationship with that enterprise (no. 4), options and other rights to demand delivery of commodities (*Waren*) or for delivery, payment or options and rights within the meaning of numbers 1 to 5 above (no. 5) and financial collateral within the meaning of section 1 para 17 KWG (no. 6). Pursuant to section 104 para 1 sentence 4 InsO financial instruments within the meaning of section 104 para 1 sentence 3 numbers 2 and 4 InsO are those instruments listed in Annex I Section C MiFID II.[148]

According to the legislative reasoning the newly enacted enumeration of financial transactions is not intended to exclude

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146 *Fried*, in: Münchener Kommentar InsO, 4th ed. (2019), § 104 InsO no. 164; *Knof*, in: Uhlenbruck, InsO, 15th ed. (2019), § 104 InsO no. 50.

147 BT-Drucksache 18/9983, p. 10.

148 It is not entirely clear whether the reference to MiFID II is intended to be static or whether this also encompasses future amendments of MiFID II. Ultimately, this appears to be irrelevant, since the non-conclusive enumeration of covered financial transactions ensures that future developments in this respect can be captured.

any financial transactions which were already covered by the version of section 104 InsO applicable prior to 10 June 2016. Rather, the changes are intended to simplify the definition of financial transactions.[149] Whether or not a transaction would be covered by section 104 para 1 sentence 3 no. 2 InsO depends on whether the transaction is aiming at the delivery of a financial instrument rather than whether the transaction giving rise to such entitlement is a financial instrument.[150] Options and other rights to demand delivery of commodities (*Waren*) covered by section 104 para 1 sentence 1 InsO as well as options and other rights to demand delivery or payment, option rights under section 104 para 1 sentence 3 nos. 1 to 5 InsO, including options on such options are covered, too.

With respect to the version of section 104 InsO applicable before 10 June 2016, the majority of German legal authors held the view that section 104 InsO may also apply to spot transactions (*Kassageschäfte*).[151] Based on the wording of section 104 InsO and the legislative reasoning we believe that this view can still be followed but we are not aware of any court decisions on this matter. Where the qualification as a financial transaction within the meaning of section 104 InsO depends on the qualification as a derivative transaction within the meaning of MiFID II, spot transactions would not qualify as financial transactions within the meaning of section 104 InsO.[152]

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149 BT-Drucksache 18/9983, p. 18.

150 BT-Drucksache 18/9983, p. 18. The legislative reasoning also clarifies that repurchase agreements and securities lending agreements fall within the scope of section 104 para 1 sentence 3 no. 2 InsO.

151 One of the arguments brought forward is that there may be a risk of loss in between signing of a contract and settlement due to market movements similar to forward transactions and which are covered by section 104 InsO. Furthermore, the wording of section 104 InsO only provides for a "specified time or a specified period agreed for the performance of financial transactions", i.e. requires a specified period or time to be agreed for performance of the obligations does, however, not stipulate a minimum period and therefore only excludes cash transactions. For more details please refer to *Bornemann*, in: Frankfurter Kommentar InsO, 9th ed. (2018), § 104 InsO no. 55; *Bosch*, Kölner Schrift zur Insolvenzordnung, 2nd ed. (1999), p. 1027 no. 72; *Fried* in: Münchener Kommentar InsO, 4th ed. (2019), § 104 InsO no. 116; for a different view see *Meyer*, in: Smid, Insolvenzordnung, 2nd ed. (2001), § 104 InsO no. 11.

152 See also Recital 8, Article 7 and Article 10 of the Commission Delegated Regulation of 25 April 2016 as regards organisational requirements and operating conditions for investment firms and defined terms for the

Spot transactions are transactions with short term delivery or respectively, fulfilment dates which are not entered into at a futures or forward market. The participants in a spot transaction agree to buy and sell, respectively, at the present market value and to settle the transaction a few days later (usually few more or even less than two business days).[153] Spot transactions, however, have to be distinguished from mere cash transactions (*Bargeschäfte*) which are settled same day and not covered by section 104 InsO.

(vi) Financial Collateral as financial transaction

Under section 104 para 1 sentence 3 no. 6 InsO, Financial Collateral within the meaning of section 1 para 17 KWG also qualifies as a financial transaction. According to the legislative reasoning this provision is intended to implement Article 7 FCD by ensuring that Financial Collateral can also be enforced by set-off under a close-out netting agreement.[154] The wording of section 104 para 1 sentence 3 no. 6 InsO only refers to Financial Collateral, i.e. the asset constituting the Financial Collateral but it does not state that transactions which are secured by Financial Collateral are within the scope of this provision. The legislative reasoning is not clear either as reference is made to the creation of Financial Collateral and that Financial Collateral, other than transactions covered by section 104 para 1 sentence 3 nos. 1 to 5 InsO, are not regarded as the "main obligation" forming part of an Executory Contract. This appears to protect Financial Collateral as such from the Selection Right but it does not create an exemption for the transactions secured by Financial Collateral which themselves do not constitute financial transactions within

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purposes of MiFID II (OJ EU No L 87 of 31 March 2017, p. 1, "**MiFID II Delegated Regulation**") pursuant to which spot contracts do not qualify as derivative instruments or financial instruments within the meaning of Annex I Section C(4) or C(7) MiFID II.

153 BGH NJW 2002, 892; *Bosch*, Kölner Schrift zur Insolvenzordnung, 2nd ed. (1999), p. 1027 no. 72. The term spot contract is defined in Article 7 para 2 MiFID II Delegated Regulation as a contract for the sale of a commodity, asset or right, under the terms of which delivery is scheduled to be made within the longer of the following periods: (a) two trading days; (b) the period generally accepted in the market for that commodity, asset or right as the standard delivery period.

154 BT-Drucksache 15/1853, p. 11, 12.

the meaning of section 104 para 1 sentences 2,3 InsO. Article 7 FCD provides that EU member states shall ensure that a close-out netting provision can take effect in accordance with its terms. To achieve the purpose of Article 7 FCD there are good arguments to construe section 104 para 1 sentence 3 no. 6 InsO broadly. However, the definition of "close-out netting" under the FCD[155] refers to financial collateral arrangements and such term again refers in our view to the collateral asset as such but not to the secured obligation or any transaction to be secured. We would therefore construe section 104 para 1 sentence 3 no. 6 InsO such that Financial Collateral may be included in the close-out netting (and, accordingly, would not be being subject to any Selection Right[156]), but the mere collateralisation of a transaction normally not covered by section 104 para 1 sentence 3 InsO does not result in the application of section 104 para 1 sentence 3 InsO. As far as we are aware, no court decisions exist in respect of the interpretation of section 104 para 1 sentence 3 no. 6 InsO.

(vii) Calculation of the amount of the claim for non-performance

Pursuant to section 104 para 2 sentence 1 InsO, the amount of any claim for non-performance is determined on the basis of the market or exchange value of the transaction.[157] Sentence 2 of section 104 para 2 InsO states that the market or exchange value is deemed to be the market or exchange price for a replacement transaction which is concluded without undue delay, but no later than on the fifth business day after the opening of insolvency proceedings (no. 1), or if no replacement transaction is entered into in accordance with no. 1, the market or exchange price for a

[155] Under Article 2 para 1 lit (n) FCD "close-out netting provision" means a provision of a financial collateral arrangement, or of an arrangement of which a financial collateral arrangement forms part, or, in the absence of any such provision, any statutory rule by which, on the occurrence of an enforcement event, whether through the operation of netting or set-off or otherwise: (i) the obligations of the parties are accelerated so as to be immediately due and expressed as an obligation to pay an amount representing their estimated current value, or are terminated and replaced by an obligation to pay such an amount; and/or (ii) an account is taken of what is due from each party to the other in respect of such obligations, and a net sum equal to the balance of the account is payable by the party from whom the larger amount is due to the other party.

[156] With respect to the version of section 104 InsO applicable before 10 June 2016, see also *Fried*, in: Münchener Kommentar InsO, 4rd ed. (2019), § 104 InsO no. 30 and no. 143.

[157] Please also refer to BT-Drucksache 18/9983, p. 20.

replacement transaction, that could have been concluded on the second business day after the opening insolvency proceedings (no. 2).

To the extent that the market conditions do not allow for the conclusion of a replacement transaction pursuant to section 104 para 2 sentence 2 numbers 1 or 2 InsO, the market or exchange value is to be determined by way of methods and procedures allowing for an adequate assessment of the value of the transaction (section 104 para 2 sentence 3 InsO). This is the case if the relevant markets are inactive or if the prices available do not properly reflect the prices that would be determined under usual market conditions.[158]

(d) Section 104 InsO and rules of central counterparties

Section 104 para 3 sentence 1 InsO provides that where transactions pursuant to section 104 para 1 InsO are combined in a master agreement or the rules of a central counterparty within the meaning of section 1 para 31 KWG, which provides that the transactions may, upon the occurrence of certain events, only be terminated in their entirety, then the entirety of such transactions shall be deemed one single transaction within the meaning of section 104 para 1 InsO. This also applies if transactions are covered by such agreement or rules, which neither qualify as fixed date transactions nor as financial transactions. Such transactions would be subject to the general provisions (section 104 para 3 sentence 2 InsO).[159] By referring to the generally applicable provisions section 104 para 3 sentence 2 InsO refers also to the Selection Right. So if and to the extent transactions neither qualify as fixed date transactions

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[158] See the legislative reasoning in BT-Drucksache 18/9983, p. 16, by reference to Article 16 of the Commission Delegated Regulation (EU) No 149/2013 of 19 December 2012 supplementing Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories (OJ EU No L 52 of 23 February 2013, p. 11).

[159] With respect to section 104 para 2 InsO as applicable prior to 10 June 2016, it was disputed among legal commentators whether (1) one non-qualifying transaction would also prevent the application of section 104 para 2 InsO for such transactions which would qualify as financial transactions, or (2) section 104 para 2 InsO applies to all transactions, even if only one or some of the transactions qualify as financial transactions or (3) only those transactions under the master agreement which qualify as financial transactions are covered by section 104 para 2 InsO, whereas such transactions which do not qualify as financial transactions remain outside its scope and are therefore individually subject to the Selection Right. This has now been clarified in section 104 para 3 sentence 2 InsO in favour of the third option.

nor as financial transactions such transactions would be subject to the Selection Right.

The InsO does not provide for a more detailed definition of the term "master agreement". Express precondition is only that the master agreement must provide for a termination of the entire agreement (including all transactions under the master agreement) where specified reasons allow for such termination. The same applies with regard to the rules of a central counterparty within the meaning of section 1 para 31 KWG.

The Rulebook, however, does not provide for the termination of all Contracts following the insolvency of a Relevant Clearing Member. Rather, LCH is given discretion to terminate certain but not all Contracts as we understand. Based on the wording of section 104 para 3 sentence 1 InsO, the Rulebook would likely not qualify as rules of a central counterparty within the meaning of such provision as we would construe the reference to the termination of transactions in their entirety to exclude any discretion as regards which transactions are to be terminated and which not. We are not aware of any court decision on this question.[160]

Rule 8 of the Default Rules provide that the relevant net amounts are determined in respect of each "kind of account"; such term further defined in Rule 11 (b) and (c) of the Default Rules. The net amounts or net sums are calculated in respect of those Contracts which are allocated to the relevant "kind of account" and LCH may establish more than one net amount or net sum, based on the number of relevant "kind of accounts" created by the Relevant Clearing Member opting for various segregation or clearing models offered by LCH (the relevant segregation or clearing models are selected and the relevant Contracts are allocated to the various segregation and clearing models before the Relevant Clearing Member has become a Defaulter). While we are not aware of any court decision on the interpretation of section 104 para 3 InsO we would not construe the reference to "one single transaction" in sentence 1 of such section as prohibiting the parties to designate in the relevant master agreement or rules of a central counterparty which transactions

[160] We also do not believe that the reference to "certain events" indicates that it may be sufficient if a specific event results in the termination of all transaction covered by the relevant agreement.

are being netted against each other by allocating the relevant transactions to different "netting sets".[161] While the relevant Contracts would likely not be treated as "one single transaction" only Contracts which would neither qualify as fixed date nor as financial transactions may be potentially subject to the Selection Right, to the extent German insolvency laws apply.

(e) Contractual close-out netting

Contractual close-out netting provisions under master agreements or rules of a central counterparty are recognised under German law and pursuant to section 104 para 4 sentence 1 InsO contractual parties may agree on provisions deviating from section 104 para 2 InsO as long as these are compatible with the fundamental principles applicable to the relevant statutory provision which is to be amended.

(i) Scope of contractual close-out netting

Pursuant to section 104 para 4 sentence 2 InsO parties may, in particular, agree that the effects of section 104 para 1 InsO may apply prior to the opening of Insolvency Proceedings, in particular upon the application by a party to the contract for the opening of Insolvency Proceedings over its assets or upon the existence of a reason for the opening for Insolvency Proceedings (contractual termination) (no. 1), that a contractual termination will encompass also such transactions pursuant to section 104 para 1 InsO in respect of which the claim for delivery of the commodities (*Waren*) or the performance of the financial transaction becomes due prior to the opening of Insolvency Proceedings, but after the point in time agreed for the contractual termination (no. 2), that for the purposes of the determination of the market or exchange value of the transaction the point in time of the contractual termination applies instead of the point in time of the opening of Insolvency Proceedings (no. 3 lit (a)), the entering into of the replacement transaction pursuant to section 104 para 2 sentence 2 no. 1 InsO may occur until the 20th business day after the contractual termination, if this is required

[161] Rather, the purpose of section 104 para 3 InsO is to address master agreements or rules of a central counterparty which include transactions falling within and transactions falling outside the scope of section 104 para 1 InsO; see also BT-Drucksache 18/9983, p. 11.

to ensure that the unwinding of the transaction is performed in a manner that will maximise value (no. 3 lit (b)), or instead of the point in time specified in section 104 para 2 sentence 2 no. 2 InsO a point in time or a period between the contractual termination and the expiry of the fifth business day following such termination shall apply (no. 3 lit (c)).

The reference to "in particular" indicates, as also stated in the legislative reasoning, that the above enumerated deviations are mere examples which are all guided by the principle that such deviations are permissible as long as these are compatible with the fundamental principles applicable to the relevant statutory requirement which is to be amended.[162] Hence, section 104 para 4 InsO limits contractual close-out netting provisions and prohibits that they contradict the purpose of the statutory close-out netting.[163] The legislative reasoning also mentions the valuation on the basis of an actual or hypothetical replacement transaction and that the relevant extended periods for valuations may only be used if and to the extent such time is necessary due to the complexity of the relevant portfolio.[164]

While we are not aware of any court decision or any further guidance in the legislative reasoning we hold the view that there is no need to explicitly refer to section 104 para 4 InsO when agreeing on any deviations from the statutory netting requirements, in particular from the timing and method of valuation set out under section 104 para 2 InsO. As already mentioned above, while single agreement clauses are generally permissible in accordance with section 104 para 3 InsO, based on our understanding of section 104 para 4 InsO parties may not agree to extend section 104 InsO to such transactions which are not covered by section 104 para 1 InsO (however bearing in mind that, with respect to financial transactions, section 104 para 1 sentence 3 InsO is not conclusive but is intended to provide for

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[162] BT-Drucksache 18/9983, p. 14.

[163] BT-Drucksache 18/9983, p. 1, 14.

[164] BT-Drucksache 18/9983, p. 22. As regards the time period relevant for valuation the legislative reasoning refers to Article 285 para 3 CRR.

examples of potentially covered transactions; see paragraph 3.2.3(c)(v) for more details).

Turning to the Rulebook, to the extent any Automatic Early Termination Event or any other event preceding a Default Notice is an insolvency related termination event the restrictions under sections 119, 104 para 4 InsO need to be observed. Section 104 InsO does not limit LCH's ability to stipulate certain insolvency related termination events *per se*. Rather, an early termination may be effected prior to the opening of Insolvency Proceedings, in particular upon the application by a Relevant Clearing Member for the opening of Insolvency Proceedings over its assets or upon the existence of a reason for the opening for Insolvency Proceedings (contractual termination pursuant to section 104 para 4 sentence 2 no. 1 InsO). Pursuant to section 104 para 4 sentence 2 no. 2 InsO a contractual termination may also encompass such Contracts in respect of which the performance of the financial transaction becomes due prior to the opening of Insolvency Proceedings, but after the point in time agreed for the contractual termination. In the absence of any additionally stipulated requirements we believe that the Rulebook does not need to make explicit reference to section 104 para 4 sentence 2 no. 2 InsO but all Contracts qualifying under such provision would be captured automatically.

As regards the timing, any potentially available discretion with respect to the exercise of LCH's rights under the Rulebook needs to be exercised in light of section 104 para 4 InsO. More specifically, the reference to the point in time when the relevant market or exchange value of the Contracts needs to be determined (section 104 para 4 sentence 2 no. 3 lit (a) InsO) and the period in time which is relevant for the entering into any replacement transactions (section 104 para 4 sentence 2 no. 3 lit (b), para 2 sentence 2 no. 1 InsO) needs also to be observed, i.e. should not exceed the maximum period specified. If and to the extent LCH would like to make use of the discretion available under section 104 para 4 sentence 2 no. 3 lit (c), para 2 sentence 2 no. 2 InsO the Rulebook would need to provide for a specific date but not later than on the fifth working day after the opening

of Insolvency Proceedings or, as the case may be, after the occurrence of the contractual termination.

(ii) Contractual close-out netting and section 119 InsO

Any contractual agreement including the rules of a central counterparty excluding or limiting the application of the Insolvency Administrator's Selection Right under section 103 InsO in advance is void (section 119 InsO). As also mentioned, in its judgments of 15 November 2012 and 9 June 2016 the BGH has construed section 119 InsO widely to better protect the insolvency estate and the Selection Right. While it is not clear to what extent the BGH will follow such decisions in future, the BGH would need to consider the legislative reasoning on the amendment of section 104 InsO. Furthermore, the BGH has also ruled that there is no room for the Selection Right where section 104 InsO applies and, thus, there is also no room for protecting the Selection Right under section 119 InsO. Accordingly, as long as the Rulebook is in line with section 104 InsO, including any deviations from section 104 para 2 InsO as permitted by section 104 para 4 InsO, the Rulebook should not be rendered void under section 119 InsO in Insolvency Proceedings.

If a court considered that a specific provision of the Rulebook violates section 119 InsO, it would, have to consider whether any potential violation would render the relevant agreement void in whole or only in part or whether the agreement needs to be construed or applied in a way that it just meets applicable statutory requirements.[165] Generally the relevant contractual term which was void cannot be construed in a way that it continues to apply to the extent it would be valid (*Verbot der geltungserhaltenden Reduktion*).[166] However, to the extent the relevant provision containing the wording which violates

[165] *Berberich*, in: Fridgen/Geiwitz/Göpfert, Beck'scher Online-Kommentar InsO, 21st ed. (as of 15 October 2020), § 119 InsO no. 37. The effects of a partial invalidity are also not addressed in section 104 para 3 sentence 2 InsO. By way of further background, the interpretation of section 119 InsO is a matter of German law only and not a matter of interpretation of the relevant contractual agreement which needs to be made under its respective governing law (see also Article 12 para 1 Rome I).

[166] See *Berberich*, in: Fridgen/Geiwitz/Göpfert, Beck'scher Online-Kommentar InsO, 21st ed. (as of 15 October 2020), § 119 InsO no. 37.

applicable law also contains wording which does not violate applicable law can be separated both from the perspective of the textual presentation and the contents then the wording which violates applicable law can be stricken off (also sometimes referred to as the "blue pencil test"). This would however mean that, after striking off the wording violating applicable law, the remaining text of the provision is in itself understandable without the need of any further interpretation or explanation.[167] The aforementioned test was developed with respect to contractual clauses rendered void under applicable contract law. However, in our view such test should also be applicable where a relevant provision is rendered void resulting from the application of section 119 InsO given that the effects of section 119 InsO are comparable to the effects of those provisions where the courts have applied the test. We are not aware of any court decisions on this question and court may not follow our view.

As the Rulebook is not governed by German law, outside Insolvency Proceedings, a German court would have to consider section 119 InsO an "overriding mandatory provision of German law" in accordance with Article 9 para 2 Rome I to hold any provisions of the Rulebook invalid. Mandatory provisions within this meaning are provisions the observance of which is regarded as crucial by a country for safeguarding its public interests, such as its political, social or economic organisation, to such an extent that they are applicable to any situation falling within their scope, irrespective of the law otherwise applicable to the contract under Rome I.

(f) Should the Netting Provisions be regarded as not being in line with section 104 para 4 InsO and should a court conclude that in such case the Netting Provisions would be held void pursuant to section 119 InsO in Insolvency Proceedings, netting is still permissible under section 104

[167] See BGHZ 107, 185, 190 *et seq*.; BGHZ 145, 203, 212; *Basedow*, in: Münchener Kommentar BGB, 8th ed. (2019), § 306 BGB no. 23; *Grüneberg*, in: Palandt BGB, 80th ed. (2021), § 306 BGB no. 7; *Roloff/Looschelders*, in: Erman BGB, 16th ed. (2020), § 306 BGB no. 11; *Schmidt*, in: Ulmer/Brandner/Hensen, AGB-Recht, 12th ed. (2016), § 306 BGB nos. 12 *et seqq*.

para 1 InsO if and to the extent the relevant Contracts falls within the scope of section 104 para 1 InsO.

(g) Summary

If LCH qualifies as a System, the consequences of the opening of Insolvency Proceedings over the assets of a participant in such System should be determined in accordance with English law pursuant to section 340 para 3 InsO so that sections 103 and 104 InsO should not apply.

If, however, the LCH does not qualify as a System, based on and subject to the above detailed reasoning, the impact of sections 103 and 104 InsO on the Rulebook (if German insolvency law applies) can be summarised as follows:

(i) To the extent not otherwise agreed in compliance with section 104 para 4 InsO as described in paragraph 3.2.3(e) above, Contracts falling within the scope of section 104 para 1 InsO are automatically terminated upon the opening of Insolvency Proceedings and the claim for non-performance resulting from such automatic termination ranks *pari passu* with any other claims of unsecured creditors (section 104 para 5 InsO).

(ii) If automatically terminated on the basis of section 104 para 1 InsO, section 104 para 2 InsO provides for the applicable valuation method, based on actual or hypothetical replacement transactions. To the extent the market conditions do not allow for the conclusion of a replacement transaction section 104 para 2 sentence 3 InsO provides that the market or exchange value is to be determined by way of methods and procedures allowing for an adequate assessment of the value of the transaction.

(iii) If a Contract is not terminated prior to the opening of Insolvency Proceedings, section 104 InsO overrides any contractual termination provision. Accordingly, fixed date transactions and financial transactions falling within the scope of section 104 para 1 InsO terminate automatically upon the opening of Insolvency Proceedings, unless such Contracts have been terminated before.

(iv) Contracts which do not fall within the scope of section 104 InsO are generally subject to the Insolvency Administrator's Selection

Right pursuant to section 103 InsO, even if the Rulebook provides for a termination of such Contracts upon the filing for Insolvency Proceedings. Any contractual provisions deviating from this principle are void (section 119 InsO). The BGH held in its judgement of 15 November 2012 that section 119 InsO applies from the point in time in which, based on a valid application for the opening of Insolvency Proceedings, such opening of Insolvency Proceedings is to be seriously expected (*mit der Eröffnung eines Insolvenzverfahrens ernsthaft zu rechnen ist*).

(h) Other acts taken by LCH in accordance with Rule 6 of the Default Rules

In addition to or alternatively to terminating Contracts, under Rule 6 of the Default Rules LCH may incur new and additional obligations on behalf of a defaulting Clearing Member for the purpose of settling or liquidating open Contracts (for example by way of entering into opposite transactions or by exercising any options on behalf of the defaulting Clearing Member).

According to section 80 para 1 InsO upon the opening of Insolvency Proceedings an Insolvent Party's right to manage and transfer the insolvency estate shall be vested in the Insolvency Administrator. Furthermore, pursuant to section 81 InsO, any dispositions of the Insolvent Party over its property made after the opening of Insolvency Proceedings are void unless the relevant court otherwise orders. Only dispositions over Financial Collateral effected after the actual opening of Insolvency Proceedings are valid, provided that such dispositions were effected on the day of the opening of Insolvency Proceedings and the other party proves that it did not know, nor should have known of the opening of the Insolvency Proceedings. A "disposition" within the meaning of section 81 InsO is any act that has a direct and immediate effect on the Insolvent Party's assets.[168]

A contractual authorisation of a third party (such as LCH) to represent the Insolvent Party would, in accordance with section 115 *et seq*. InsO expire upon the opening of Insolvency Proceedings. If the exercise of LCH's rights under Rule 6 were therefore based on a contractual

[168] For examples, see, *Lüke*, in: Kübler/Prütting/Bork, InsO, 86th ed. (December 2020), § 81 InsO no. 4.

authorisation, such authorisation could not be upheld in Insolvency Proceedings.

If LCH qualifies as a System, section 340 para 3 InsO may refer to substantial English insolvency laws also with respect to these further measures taken by LCH under Rule 6 instead of applying the provisions of the InsO. Section 340 para 3 InsO refers not only to specific types of agreements (unlike section 340 para 2 InsO) but constitutes a conflicts of laws provision for "rights and obligations of participants in the System". However, the precise scope of application of section 340 para 3 InsO has not been subject to any court decision and there is, in particular, no guidance as to what extent section 340 para 3 InsO prevails over conflicting conflict of laws provisions as for example section 339 InsO governing challenge in insolvency or section 351 InsO governing rights *in rem* as regards assets that are located in Germany at the opening of foreign insolvency proceedings.

(i) Insolvency-related set-off

In addition, if substantive German insolvency law applies (please see for its scope of application the conflict of laws analysis in paragraphs 3.2.3(a) and 3.2.3(b) above) insolvency-related restrictions on set-off may be relevant because the netting provisions under the Rulebook, in particular Rule 8 of the Default Rules, involve elements of set-off and, as mentioned above, section 104 InsO provides for the termination of Contracts to form a basis for set-off and provides for the calculation of compensation claims which may serve as a basis for set-off (above, footnote 169) but, in particular absent a master agreement, does not effect the aggregation of compensation claims by set-off.

The following provisions govern set-off upon the opening of Insolvency Proceedings over the assets of the Relevant Clearing Member and are therefore relevant to any set-off agreements (such as settlement and general set-off arrangements irrespective of an early termination and aggregation) if German substantial insolvency law applies.

(i) Set-off after the opening of Insolvency Proceedings

The right of a Solvent Party to effect set-off after the opening of Insolvency Proceedings is governed by sections 94 through 96 InsO. The extent to which a set-off after the opening of

Insolvency Proceedings is permissible mainly depends on the point in time when the situation giving one party the right to set off comes into existence *(Entstehung der Aufrechnungslage*). This is in our view to be determined in accordance with the applicable contract law as determined in accordance with applicable conflict of laws provisions.

Pursuant to section 94 InsO and subject to the restrictions and prohibitions of set-off pursuant to sections 95 and 96 InsO, a right to set off a claim is preserved after the opening of Insolvency Proceedings if by force of law or on the basis of an agreement the Solvent Party was already entitled to set off the claim at the time the Insolvency Proceedings were opened irrespective of whether or not the declaration to set off the claim was made before or after the opening of such Insolvency Proceedings.[169]

The InsO explicitly preserves rights to set off a claim under valid contractual agreements. With respect to the overall intention of the InsO in general and the purpose of section 94 InsO in particular, i.e. the aim to protect the legitimate expectations of the creditors of the Insolvent Party, the preservation of contractual rights to set off has been criticised since it enables the parties to extend the rights to set off to the detriment of

[169] It could be argued it is not required to assess whether a contractual netting arrangement falling within the scope of section 104 InsO meets the requirements of sections 94 *et. seqq*. InsO where the netting (*Verrechnung*) of claims is made through the calculation of the relevant claim for non-performance within the meaning of section 104 InsO. Section 104 paras 1 and 2 InsO refer to the relevant single transaction, however pursuant to section 104 para 3 InsO the entirety of the transactions combined in a master agreement or the rules of a central counterparty are deemed to be a single transaction within the meaning of section 104 para 1 InsO. Accordingly, if this deeming provision results in a single transaction, set-off would not be required, as all respective amounts would simply be items to be included in the single payment claim resulting in a single settlement amount. As set out above, however, we interpret section 104 InsO that it does not include any set-off but, by transforming the former payment and delivery claims into a Euro denominated payment claim, provides a basis for set-off. See *Lüer*, in: Uhlenbruck, InsO, 15th ed. (2019), § 104 InsO no. 18; *Fuchs*, Close-out Netting, Collateral und systemisches Risiko, 2013, p. 106; *Ehricke*, ZIP 2003, 273 *et seqq.*, 277; *Bosch*, WM 1995, 413 *et seqq*., 419 (differing view *von Hall*, Insolvenzverrechnung in bilateralen Clearingsystemen, 2011, p. 152, p. 156 *et seqq*.). Section 104 para 4 InsO allows, within the limits of the provision, contractual arrangements, which, however, have the characteristics of a contractual set-off agreement and must therefore comply with sections 94 *et seqq.* InsO. Unclear in this respect *Berberich*, in: Fridgen/Geiwitz/Göpfert, Beck'scher Online-Kommentar InsO, 21st ed. (as of 15 October 2020), § 104 InsO nos. 32 and 43. The statement in BT-Drucksache 18/9983, p. 21, in our view refers to other circumstances.

creditors of the Insolvent Party as such agreements might reduce the assets involved in insolvency.[170] The validity of contractual agreements concerning set-off is therefore called into question in German legal literature and a restrictive interpretation of section 94 InsO pursuant to which agreements concerning set-off may not override prohibitions of set-off that aim at protecting third parties' rights is proposed.[171] According to this view, such agreements also have to comply with sections 95 and 96 InsO and might be challenged pursuant to section 129 at seqq. InsO.

However, this restrictive approach particularly applies to agreements deviating from the requirement of mutuality of the claims under German statutory law and should not affect the validity of the contractual provision of automatic aggregation and set-off of all existing mutual payment obligations of the parties under the transactions where the relevant contractual provisions do not contain a contractual deviation from the requirement of mutuality of the claims.

(ii) Restrictions under section 95 InsO

In circumstances where the right to set off emerges after the opening of Insolvency Proceedings, set-off will only be permissible if the mutual claims originated before the opening of Insolvency Proceedings. If on the date when Insolvency Proceedings are opened one or more of the claims to be set off against each other are conditional, not yet due or do not cover similar types of obligations, such set-off will not be effected before such conditions are met (section 95 para 1 sentence 1 InsO). Pursuant to section 95 para 1 sentence 2 InsO, section 41 InsO concerning claims not yet due at the date when Insolvency Proceedings are opened and section 45 InsO concerning the conversion of certain claims do not apply.

Set-off is excluded if the claim against which a set-off is to be effected becomes unconditional and mature before it can be set

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[170] *Lüke*, in: Kübler/Prütting/Bork, InsO, 86th ed. (December 2020), § 94 InsO no. 7.

[171] *Kroth*, in: Braun, InsO, 8th ed. (2020), § 95 InsO no. 23; *K. Schmidt*, NZI 2005, 138, 140 *et seq.*; see also *Lohmann/Reichelt*, in: Münchener Kommentar InsO, 4rd ed. (2019), § 94 InsO nos. 63 *et seq*.

off (section 95 para 1 sentence 3 InsO). With respect to set-off after the opening of Insolvency Proceedings, timing, therefore, is of fundamental importance. Set-off is permissible if the Solvent Party's claim is unconditional and matures prior to the Insolvent Party's claim or at the same time at the latest.[172]

Pursuant to section 95 para 2 InsO, the fact that claims are expressed in different currencies or mathematical units would not exclude set-off, if these currencies or mathematical units are freely exchangeable at the place of payment of the claim against which the set-off is to be effected.[173] The claims have to be converted according to the exchange value applicable to this place at the time of receipt of the declaration to set-off.

(iii) Further restrictions under section 96 InsO

In addition, pursuant to section 96 para 1 InsO, set-off is prohibited if (i) a creditor in the Insolvency Proceedings has become a debtor of the insolvency estate only after the opening of Insolvency Proceedings, (ii) a creditor in the Insolvency Proceedings acquired his claim from another creditor only after the opening of Insolvency Proceedings, (iii) a creditor in the Insolvency Proceedings acquired the opportunity to set off his claim by a legal act subject to challenge in insolvency (below, paragraph 3.2.4(a) or (iv) a creditor with a claim to be satisfied from the debtor's free property is a debtor of the insolvency estate (section 96 para 1 InsO).

(iv) Set-off and challenge in insolvency

In the event an insolvency creditor acquired the right to set off his claim by a transaction which may be challenged, set-off is prohibited pursuant to section 96 para 1 no. 3 InsO. This

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[172] Moreover, section 95 para 1 sentence 3 InsO has been construed restrictively by the BGH in NJW 2005, 3574, 3575 *et seq.* According to the BGH, section 95 para 1 sentence 3 InsO does not apply if the Insolvent Party's claim, against which set-off is declared, has become mature and unconditional before the Solvent Party's claim but at the same time was not enforceable due to a right to refuse performance by the Solvent Party against such claim.

[173] This is considered as a general principle of German law which also applies under section 94 InsO even though it is not mentioned therein (*Höhn/Kaufmann*, JuS 2003, 751, 753).

prohibition applies irrespective of whether or not the Insolvency Administrator has actually challenged the transaction. The BGH has decided that a legal act will not be prevented from becoming subject to challenge in insolvency and, consequently, the prohibition on set-off under section 96 para 1 no. 3 InsO is not excluded if the legal act at hand caused the claim against which set-off is declared to come into existence.[174] In particular, the BGH rejected the argument that the fact that such a legal act does not only create the right to set-off but also the claim against which set-off is declared and which becomes part of the Insolvent Party's assets should be taken into account in determining whether the legal act is detrimental to creditors (as required by section 129 para 1 InsO (see paragraph 3.2.4(a)(ii))). Therefore, if a German court took the view that German law on insolvency-related set-off apply to the Default Rules (see, however, paragraphs 3.2.3(a) and 3.2.3(b) with respect to the conflict of laws analysis), it could reach the conclusion that the exercise of powers of LCH to bring claims into existence under Rule 6 of the Default Rules as a result of a Relevant Clearing Member's default constitute legal acts which are potentially subject to challenge in insolvency and therefore prevent set-off in respect of claims created by such legal acts pursuant to section 96 para 1 no. 3 InsO.

(v) Exemptions for Financial Collateral and Systems

The prohibitions of set-off pursuant to section 95 para 1 sentence 3 InsO and section 96 para 1 InsO do neither apply to the transfer of Financial Collateral nor to the set-off of claims and benefits from transfer, payment or settlement agreements introduced into a System where set-off is effected at the latest on the day of opening of the Insolvency Proceedings (section 96 para 2 InsO).

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*

[174] BGH WM 2013, 1132, 1133.

exemptions from the relevant arrangements for avoidance or challenge available under the law of the Relevant Jurisdiction in respect of contracts in financial markets?

(a) Challenge in insolvency

Any legal acts performed in accordance with the Opinion Documents may be subject to challenge in insolvency. The applicable German conflict of laws provisions as regards these rules are determined either by the EUIR or the InsO.

(i) Conflict of laws analysis

Article 16 Recast EUIR provides that the law of the EU member state of the opening of proceedings does not apply, if the beneficiary of the relevant act proves that the act is subject to the laws of an EU member state other than that of the EU member state of the opening proceedings and that such law does not allow any means of challenging that act in the relevant case. Where the InsO applies, section 339 InsO provides that German provisions on challenge in insolvency do not apply, if the beneficiary of the relevant act proves that the act as a whole is subject to the laws of a country other than Germany and that such law does not allow any means of challenge in insolvency the act at the case in point.

(ii) German challenge in insolvency in general

If BaFin has, prior to a Relevant Clearing Member's insolvency, taken measures under section 46 para 1 KWG such as a Moratorium to prevent the Relevant Clearing Member from becoming illiquid and Insolvency Proceedings are subsequently opened, challenge periods begin to run (counting backwards) on the day on which such an order has been issued (section 46c para 1 KWG) rather than on the later day of the filing for Insolvency Proceedings which is usually relevant. Furthermore, where legal acts have been made between the imposition of regulatory measures by BaFin in accordance with section 46 para 1 sentence 2 nos. 4 to 6 KWG and an application for the opening of Insolvency Proceedings, such legal acts are deemed

not to be detrimental to creditors as a whole (section 46c para 2 sentence 1 KWG).

(iii) Challenge provisions relevant to legal acts made in connection with a Clearing Member's clearing through LCH

Legal acts made in connection with the Opinion Documents may, in particular, be subject to challenge in insolvency under the following circumstances:

(A) Under section 130 para 1 sentence 1 InsO, a legal act is subject to challenge, if it gives or makes available to a creditor security or satisfaction and (i) it was effected during the last three months prior to the filing for the opening of Insolvency Proceedings, if the insolvent Relevant Clearing Member was unable to pay its debts when due at the time of the legal act and if the creditor had knowledge of such inability to make payments at such time; or (ii) it was effected after the filing for the opening of Insolvency Proceedings and the creditor had knowledge of the insolvent Relevant Clearing Member's inability to make payments or the petition for opening of Insolvency Proceedings at the time of the legal act ("congruent coverage" (*kongruente Deckung*)).

Knowledge of circumstances which necessarily lead to the conclusion that the Relevant Clearing Member was unable to make payments is regarded as equivalent to actual knowledge of the insolvent Relevant Clearing Member's pending inability to make payments or of the filing for opening of Insolvency Proceedings (section 130 para 2 InsO).

(B) Pursuant to section 131 InsO, a challenge period of one to three months applies where a legal act gives or makes available to a creditor, security or satisfaction to which it has no right or no right to claim in such manner or at such time, and the corresponding legal act is subject to challenge if either, (i) the legal act is effected during the last month prior to filing for the opening of Insolvency Proceedings or following such filing; or, (ii) the legal act

is effected during the second or third month prior to filing for the opening of Insolvency Proceedings and the insolvent Relevant Clearing Member was unable to make payments at the time of the legal act or, (iii) if the legal act is effected during the second or third month prior to filing for the opening of Insolvency Proceedings and the creditor has knowledge at the time of the legal act that it is detrimental to the insolvent Relevant Clearing Member. In relation to (iii), knowledge of circumstances that necessarily lead to the conclusion that a legal act is detrimental to the insolvent Relevant Clearing Member is equivalent to actual knowledge of such detriment (section 131 para 2 InsO ("incongruent coverage" (*inkongruente Deckung*))).

(C) A legal transaction (*Rechtsgeschäft*) by the insolvent Relevant Clearing Member that is directly detrimental to the creditors is subject to challenge action, (i) if it was effected in the last three months prior to the filing for the opening of Insolvency Proceedings, if the insolvent Relevant Clearing Member was unable to pay its debts when due at the time of the legal transaction and if the other party had knowledge of such inability to make payments at such time; or, (ii) where it was effected after filing for the opening of Insolvency Proceedings and the other party had knowledge of the inability of the insolvent Relevant Clearing Member to make payments or of the petition for opening of Insolvency Proceedings at the time of the legal transaction (section 132 para 1 InsO).

A legal transaction which involves the Insolvent Party losing a right, or pursuant to which the Insolvent Party is no longer able to assert such a right, or which results in a property claim against the Insolvent Party being maintained or becoming enforceable is equivalent to a legal act that is directly detrimental to the creditors (section 132 para 2 InsO).

(D) A legal act made by the Insolvent Party during the last ten years prior to the filing for the opening of Insolvency Proceedings, or subsequent to such request, with the intention to disadvantage his creditors may be subject to challenge in insolvency, if the other party was aware of the debtor's intention on the date of such legal act (section 133 para 1 sentence 1 InsO). If such legal act was made to satisfy or secure an existing obligation, the challenge period is shortened to four years (section 133 para 2 InsO). Awareness of the other party is presumed if such party knew (1) of the imminent inability of the Insolvent Party to make payments when due (*drohende Zahlungs-unfähigkeit*) or, where the other party is entitled to receive the satisfaction or security in such way or at such time, of the (actual) inability of the Insolvent Party to pay its debt (*eingetretene Zahlungsunfähigkeit*) and (2) that the legal act constituted a disadvantage for the creditors (section 133 para 1 sentence 2, para 2 sentence 1 InsO). Awareness of corresponding circumstances provides severe evidence for knowledge of the other party of the imminent inability of the Insolvent Party to make payments when due. Further, pursuant to section 133 para 3 sentence 2 InsO, the other party is deemed not to have had knowledge of the inability to pay, if it has agreed upon special payment terms with, or has granted any other form of payment relief to, the Insolvent Party.

Under section 133 para 4 InsO, a contract for a consideration entered into by the Insolvent Party and a person with whom the Insolvent Party has a close relationship which is directly detrimental to the creditors is subject to challenge in insolvency unless it was entered into more than two years prior to the filing for the opening of Insolvency Proceedings or the other party was unaware of an intention of the Insolvent Party to prejudice the creditors.[175] In respect of person with whom the Insolvent Party has a close relationship, the requisite

[175] If the Insolvent Party is a legal person, the term "person with whom the insolvency debtor has a close relationship" is defined in section 138 para 2 InsO.

knowledge or awareness of the relevant circumstance under the different challenge provisions is deemed to exist (sections 130 para 3, 131 para 2 sentence 2 and 132 para 2 InsO)

(E) Under section 147 sentence 1 InsO legal acts which are performed after the opening of the Insolvency Proceedings but are legally effective in accordance with section 81 para 3 sentence 2 InsO (above, paragraph 3.2.1(g)) may be subject to challenge in insolvency. The provisions governing a challenge in insolvency in respect of legal acts performed before the Insolvency Proceedings were opened (as set out in this paragraph) apply under section 147 sentence 1 InsO as if the relevant legal acts had been made before Insolvency Proceedings were opened. In respect of legal acts relating to claims and performances which fall within the scope of section 96 para 2 InsO (below, paragraph 3.2.3(i)(iv)) the application of section 147 sentence 1 InsO shall, however, not reverse the set-off of account balances or affect the validity of the payment orders, orders of payment services providers or intermediate providers or orders for the transfer of securities (section 147 sentence 2 InsO).

(b) Defences to challenge in insolvency

Section 130 para 1 sentence 1 InsO is not applicable where the relevant legal act is based on a security agreement which contains the obligation to provide Financial Collateral, to replace Financial Collateral by other Financial Collateral or to provide additional Financial Collateral in order to readjust the relation between the value of the obligation and the value of the collateral as set forth in the security agreement (*Margensicherheit*; margin collateral (section 130 para 1 sentence 2 InsO). Any English law charge (or any security interest under the laws of another state) or full title transfer qualifying as Financial Collateral and made to secure obligations under the Opinion Documents would therefore not be subject to challenge in insolvency pursuant to section 130 para 1 sentence 1 InsO to the extent any legal assets serve the provision or replacement of (additional) Financial Collateral in order to readjust the relation between the value of the obligation and the value of the

collateral as set forth in the security agreement. Initial margin is calculated to cover LCH's potential future exposures to counterparties in the interval between the last margin requirement and the close-out of Contracts and liquidation of collateral following a counterparty's default. Variation margin may therefore qualify as margin collateral whereas initial margin should not qualify as such.[176]

Section 142 para 1 InsO provides that a payment on the part of the Insolvent Party in return for which the Insolvent Party's property benefited directly (*unmittelbar*)[177] from an equivalent (*gleichwertig*) consideration may only be challenged if such payment was made with the intention to prejudice the creditors as set out in section 133 paras 1 to 3 InsO and the other party is aware that the Insolvent Party was acting dishonestly (*unlauter*).

(c) Avoidance outside Insolvency Proceedings

Under the German Avoidance Act (*Anfechtungsgesetz*, "**AnfG**") a creditor is entitled to challenge outside Insolvency Proceedings legal acts of a debtor which are detrimental to creditors if the creditor has obtained an enforcement order (*vollstreckungsfähiger Titel*) and its claims are due and payable, but any enforcement actions against the debtor's estate either did not result in the full satisfaction of the creditor's claim or it can be assumed that any such enforcement actions will not be successful to satisfy the creditor's claim. Section 19 AnfG provides for a special conflict of laws rule as regards avoidance under the AnfG and refers to the laws of the jurisdiction which governs the relevant legal

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[176] Section 130 para 1 sentence 1 InsO refers to the adjustment of the relation between the values of the secured obligations and the value of the collateral. While initial margin may be adjusted as well this is not normally due to a change in the values of secured obligations and security provided but rather constitutes a measure based on the generally perceived volatility in the market; see *Kayser/Freudenberg*, in: Münchener Kommentar InsO, 4rd ed. (2019), § 130 nos. 5d and 5e; *de Bra*, in: Braun, InsO, 8th ed. (2020), § 130 InsO no. 44.

[177] Pursuant to section 142 para 2 InsO, the reciprocal obligations are performed "directly" (*unmittelbar*) if there is – taking into account the nature of the goods and services exchanged and the relevant business practices in relation to relevant types of contract – only a short delay between the respective performances (*enger zeitlicher Abstand*). This does not necessarily require a simultaneous performance. However, in order to be able to rely on this exemption, the exchange would still ideally take place simultaneously as it could be difficult to prove any particular business practice in this type of transaction so that there remains a risk that, where the exchange is not simultaneous, this exemption may not apply.

act.[178] For a successful challenge the relevant legal act muss fall within the applicable suspect periods.

Under section 3 para 1 AnfG a legal act made by the debtor during the last ten years prior to the challenge, with the intention to disadvantage its creditors may be subject to challenge, if the other party was aware of the debtor's intention on the date of such legal act (such awareness is presumed if the other party knew of the imminent inability of the debtor to make payment when due, and that the transaction constituted a disadvantage for the creditors). Additional challenge rights apply, *inter alia*, to legal acts with closely related persons and to legal acts without consideration.

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*?

Yes, within the scope of application of the InsO, section 104 InsO provides for a mandatory automatic termination of those transactions which fall within the scope of section 104 InsO upon the opening of Insolvency Proceedings (see above paragraph 3.2.3(c)).

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

In order to receive payment of claims in Insolvency Proceedings, the creditor of an Insolvent Party should register its claims with the Insolvency Administrator within a certain period of time supporting the registration with the relevant documents and state the basis and amount of the claim (section 174 para 1 InsO).[179]

After the opening of Insolvency Proceedings, for the purposes of such registration cash payment claims against an Insolvent Party in a currency other than Euro must be converted into Euro at an exchange rate applicable at the

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[178] *Kirchhof*, in: Münchener Kommentar zum Anfechtungsgesetz, 1st ed. (2012), § 19 AnfG nos. 7 *et seq*. Depending on the relevant legal act, this may be the *lex causae, lex rei sitae or lex cartae sitae*, see paragraph IV.C.3.15(c) above for further details.

[179] This does not apply to claims of a creditor having a right to segregation (*Aussonderungsrecht*) or creditors of the estate, *Riedel*, in: Münchener Kommentar InsO, 4rd ed. (2019), § 174 InsO no. 7.

place of performance at the time of the opening of the Insolvency Proceedings (section 45 sentence 2 InsO).

According to the BGH, the official exchange rate applicable on the date of the opening of Insolvency Proceedings at the place of payment applies and the place of payment is the place where the Insolvency Proceedings have been opened.[180] With respect to enforcement proceedings, however, it is proposed that cash payment claims in a currency other than Euro are converted at the official conversion rate on the date and at the place of payment.[181]

3.3 Client Clearing

It is contemplated that Relevant Clearing Members offer or are entitled to offer Client Clearing Services to their Clearing Clients in accordance with the provisions of the Rulebook (including, in particular, Regulation 11 and the Client Clearing annex to the Default Rules). LCH requires legal advice in the Relevant Jurisdiction as to whether the default arrangements providing for:

- *the porting of the Contracts entered into on behalf of a Clearing Client ("**Client Contracts**") and the associated Account Balance to a Backup Clearing Member; or*

- *the liquidation of Client Contracts and the return of the relevant Client Clearing Entitlement directly to the relevant Clearing Client or (failing that) to the relevant Defaulter for the account of such client,*

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

The porting of Client Contracts may be effected by either:

- *a close-out of the relevant Client Contracts between LCH and the Defaulter followed by the replication of such Contacts (by the opening of new Client Contracts on the same terms) between LCH and the Backup Clearing Member; or*

[180] BGH NJW 1989, 3155 (on the KO); *Andres*, in: Nerlich/Römermann, InsO, 41st update (as of June 2020), § 45 InsO no. 4; see, however, *Bitter*, in: Münchener Kommentar InsO, 4th ed. (2019), § 45 InsO no. 20.

[181] *Bach*, in: Vorwerk/Wolf, Beck'scher Online-Kommentar ZPO, 38th ed. (1 September 2020), § 722 ZPO no. 27.

- *a transfer of the relevant Client Contracts (in the form of open positions and without close-out) from the Defaulter to the Backup Clearing Member.*

Please consider both alternative porting mechanisms when providing your answers below and (if applicable) highlight any differences in the analysis of one compared with the other.

Please note that it cannot be assumed in all cases where LCH returns a Client Clearing Entitlement to a Defaulter for the account of a Clearing Client that the relevant Clearing Client will:

- *have taken enforcement action under the Security Deed;*
- *have instructed LCH to take that course of action; and/or*
- *necessarily even be known to LCH.*

In these circumstances, LCH will return the Client Clearing Entitlement to the Defaulter on the basis that the relevant assets are assets of the Clearing client and should be treated as such.

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 Exempting Client Clearing 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 Exempting Client Clearing 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.

We understand that an "Exempting Client Clearing Rule" would be any law or regulation protecting the validity of actions taken under the Client Clearing Annex of the Default Rules (in particular the porting of client assets and positions to a backup clearing member) from challenge under the insolvency laws applicable to the Relevant Clearing Member.

As already outlined in paragraph 3.2.1, the InsO and EGInsO provide for different exemptions from application of its restrictions, in particular the challenging rights thereunder.

(a) Article 102b EGInsO

Where German insolvency laws apply, Article 102b EGInsO provides for a general rule under which certain mandatory provisions in Insolvency Proceedings and Provisional Insolvency Measures do not apply if they would impair measures considered necessary in accordance with Article 48 EMIR (see paragraph 3.2.1(h)). However, as stated under paragraph 3.2.1(i) above, as a third country system LCH would not be subject to Article 48 EMIR and hence the exemptions under Article 102b EGInsO would not be applicable.

(b) Rules applicable to Systems

Further specific exemptions from certain mandatory restrictions under the InsO apply to Systems, please see also paragraph 3.2.1(h) above.

In Insolvency Proceedings specific conflict of laws provisions apply with respect to rights and obligations of participants in Systems (Article 12 Recast EUIR, see paragraph 3.2.3(a), and section 340 para 3 InsO, see paragraph 3.2.3(b)(iii)). Within the scope of application of the InsO, exemptions for Systems apply with respect to insolvency related set-off (paragraph 3.2.3(h) below) and the enforcement of security (paragraph 3.2.2(c) below).

While we take the view that the LCH qualifies as a System, absent any court decisions on the definition of the term "System" and on the scope of application of section 340 para 3 InsO, a German court may also take a different view.

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*?

(a) Porting under the Rulebook

Prior to analysing the rights of a Relevant Clearing Member or other person to successfully challenge the actions of LCH, we summarise our understanding of the term "porting" as used herein as follows:

"Porting" includes the transfer of Client Contracts of a Relevant Clearing Member (by way of novation) to a Backup Clearing Member, together with the Account Balances pursuant to the Default Rules, including the Client Clearing Annex.[182] In such case, the Relevant Clearing Member is "deprived" of any entitlement to the collateral posted by it (in the form of either the Account Balance or the Client Clearing Entitlement) as it is transferred to the Backup Clearing Member. The term "Account Balance" as defined in the General Regulations means such part of the collateral granted by the Relevant Clearing Member which is attributable to the relevant client account held by the Relevant Clearing Member on behalf of such client and which is attributed by LCH to the relevant client.

Collateral granted in this context means either security over cash which is granted by way of outright title transfer or, with respect to non-cash collateral granted under the Deed of Charge, any cash amounts after realisation of the relevant security interest that exceed the Relevant Clearing Member's obligations to LCH.

(b) Contractual law analysis

If Insolvency Proceedings have not been opened over the assets of a Relevant Clearing Member, the choice of English law to govern the transfer or termination and re-establishment of Contracts as a

[182] The relevant rules are General Regulation 11 and Rules 6 to 9 of the Client Clearing Annex (set out in Schedule 1 to the Default Rules).

contractual matter and the agreement on the scope and preconditions for release of collateral as a contractual matter would, from a German conflict of laws perspective generally be recognised unless it involved the transfer of property rights, in which case mandatory conflict of laws rules must be observed (see paragraph 3.2.2(b) above).

(c) Insolvency laws affecting porting

If Insolvency Proceedings are opened, German mandatory insolvency laws including provisions on challenge in insolvency would apply to the transfer (see generally paragraph 3.2.4(a) above).

However, special conflict of law provisions would apply to LCH if it qualified as a System and refer to English substantive law (section 340 para 3 InsO). Section 340 para 3 InsO refers to the rights and obligations of participants in Systems and, to the extent such rights and obligations are created by the rules of the System, we believe that the effects of insolvency proceedings on such rights and obligations are governed by the laws of the state which applies to the System (above, paragraph 3.2.1(h)). This would in our view also apply to any rights and obligations with respect to porting if provided by the rules of the System as the wording generally refers to the effects of insolvency proceedings on the rights and obligation of a participant rather than to specific legal arrangements such as netting agreements.[183] We are not aware of any court decisions on this question and a court may not follow our analysis.

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*?

If Insolvency Proceedings have not been opened over the assets of a Relevant Clearing Member, the choice of English law to govern the scope of the Relevant

[183] See *Jahn/Fried*, in: Münchener Kommentar InsO, 4th ed. (2020), § 340 InsO no. 9.

Clearing Member's claim for return of the Client Clearing Entitlement[184] as a contractual matter would, from a German conflict of laws perspective generally be recognised unless it involved the transfer of property rights, in which case different conflict of laws rules apply (see paragraph 3.2.2(b) above).

With respect to Insolvency Proceedings being subsequently opened, please see paragraph 3.3.2(c) above and paragraph 3.3.6 below.

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 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*?

If LCH qualifies as a System both, Article 12 Recast EUIR and section 340 para 3 InsO would refer to English substantive law with respect to effects of Insolvency Proceedings (see paragraphs 3.2.3(a), 3.2.3(b) and 3.2.4(a)(i) above) given that the Opinion Documents (including the account relationships of all collateral accounts) are governed by English law. On this basis, provided the arrangements of the Opinion Documents are effective and allow the distinction of a Client's assets from any other assets as a matter of English law (as to which we express no opinion) neither porting of assets related to Accounts which are segregated under the Opinion Documents nor the porting of Client Contracts and the Account Balance of a Clearing Client to a Backup Clearing Member would be affected by the opening of Insolvency Proceedings if the arrangements providing for segregation and portability as between LCH, the defaulting Relevant Clearing Member, its Client and the backup Clearing Member are valid and all transfers are validly made as a matter of English law.

As mentioned previously, the precise scope of application of section 340 para 3 InsO has not been subject to any court decision and there is, in particular, no guidance as to what extent section 340 para 3 InsO prevails over conflicting insolvency conflict of laws provisions as for example section 339 InsO governing challenge in insolvency or section 351 InsO governing rights *in rem*

[184] Such term defined in Clause 9.1 of the Client Clearing Annex as "the entitlement to Collateral (and any close-out amounts referred to in (a) of this paragraph 9.1) (the "**Client Clearing Entitlement**") of the Defaulter in respect of each such Clearing Client […]".

as regards assets that are located in Germany at the opening of foreign insolvency proceedings. Furthermore, section 340 para 3 InsO does not address property law aspects and it is therefore necessary to ensure that all transfers comply with applicable property law.

However, if German insolvency laws apply, the restrictions set out under paragraph 3.2.1(a) above in particular the prohibitions on the Insolvent Party to dispose of its assets apply and have to be observed. The porting of Client Contracts would potentially be subject to all the restrictions the opening of Insolvency Proceedings entails (see paragraph (a)), including challenge in insolvency (see paragraph 3.2.4) but partial exemptions may apply. Such partial exemptions are available if Financial Collateral is granted (see paragraph 3.2.1(g)). Furthermore, where "porting" is effected by means of close-out and re-establishment, the analysis given in respect of close-out netting at paragraph 3.2.3(c) above applies. Upon the opening of Insolvency Proceedings security interests generally must be enforced in accordance with the InsO, i.e. it would have to be determined whether a security interest grants a right for segregation or separate satisfaction (paragraph 3.2.2(c)).

In addition to restrictions under insolvency laws (and even if an exemption applied), any transfer would have to be made in accordance with applicable civil and property law requirements. If applicable, German law, for example, would not allow for the transfer of pledged assets unless the pledgor, the legal owner of the assets, has given its consent. Where Insolvency Proceedings are opened over the assets of a pledgee this would under German law not result in the pledge ceasing to exist. Rather, the pledge would continue to exist until the security purpose ceased to exist.

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*?

Please refer to our comments made in paragraph 3.3.4.

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 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?

Please see paragraph 3.2.1 for an overview of Insolvency Proceedings, Provisional Insolvency Proceedings and Regulatory Proceedings under the laws of Germany.

Certain measures under Regulatory Proceedings such as the closure of a Relevant Clearing Member for ordinary business with clients (section 46 para 2 sentence 2 no. 5 KWG), the imposition of a Moratorium and, in particular, a Resolution Order may affect portability (see further paragraph (d) above). Taking the view that LCH qualifies as a System or that ported positions qualify as Financial Collateral, however, exemptions are available (above, paragraphs 3.2.1(h)).

To summarise, German law generally refers to English law as far as contract aspects of actions taken in connection with the Default Rules are concerned, while restrictions under Insolvency and Regulatory Proceedings as well as Provisional Insolvency Measures may affect porting. Exemptions would be available if LCH qualifies as a System or if porting involves Financial Collateral.

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*?

Please see paragraph 3.3.6 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 from the fact pattern that German conflict of laws provisions on the creation of a security interest refer to English law because no assets located in Germany are the subject of the security interest to be created under the Security Deed.

Please see above in paragraph 3.2.2 for an analysis with respect to a security interest governed by English law including an analysis of applicable mandatory conflict of laws provisions as regards the valid creation of a security interest.

Section 1 para 17 sentence 4 KWG states that security providers from third countries are treated the same if they are substantially equal to the entities enumerated in Article 1 para 2 lit (a) to (e) FCD, i.e. the definition of Financial Collateral is not necessarily limited to EU jurisdictions or entities located in member states.

The security interest created under the Security Deed qualifies as Financial Collateral if (i) the Chargor is an eligible security provider[185], (ii) the security interest is created over an eligible type of asset and (iii) the security interest qualifies as *in rem* security arrangement or outright title transfer (see also paragraph 3.2.2 above with respect to the Deed of Charge).

If the relevant Charged Assets consists of cash deposits or cash amounts and securities then they would qualify as eligible assets. As mentioned, not every claim to demand a payment qualifies as such a monetary claim or cash amount. Only assets expressly listed in section 1 para 17 KWG qualify as eligible assets.

As set out above, the relevant security interest must qualify as *in rem* security arrangement or outright title transfer. In this respect, Article 2 para 1 lit. c) FCD defines a security financial collateral arrangement as an arrangement under which a collateral provider provides financial collateral by way of security to or in favour of a collateral taker, and where the full or qualified ownership of, or

[185] As regards LCH's status as eligible secured party see paragraph 3.2.1(g).

full entitlement to, the financial collateral remains with the collateral provider when the security right is established. If, as a matter of English law, on which we do not opine, the charge under the Security Deed would qualify as such security financial collateral arrangement and a court came to the view that, by applying the doctrine of transposition, the charge could be seen to be sufficiently similar to a German law type of security interests over cash or movables (such as a pledge or a security assignment/security transfer, which constitute *in rem* security arrangements under German law), the Security Deed would constitute Financial Collateral. We are however not aware of any court decisions confirming this view. To the extent that the security provider is entitled to dispose over collateral (at least in cases which do not relate to a right to substitution or withdrawal of excess collateral), which under the Security Deed is a question of English law on which we do not opine, there would be a risk that a court could take the view that the qualification as Financial Collateral is endangered (see paragraph 3.2.1(g)).

If LCH qualifies as a System, the effects of Insolvency Proceedings on the rights and obligations of participants in a System within the meaning of section 1 para 16 KWG would be governed by the laws of the state which applies to that System rather than being subject to the provisions of the InsO, please see as to the effects and scope of application of section 340 para 3 InsO; paragraph 3.2.3(b)(iii).

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*?

To the extent German conflict of laws provisions refer to English law with respect to the creation of a security interest, no filing or registration is required under German law in addition to any English law requirements to ensure that German law recognises the validity of the security interest as the recognition of the English law as the law governing the security interest also extends to any filing, registration or perfection requirements.

Further, there are no filing or registration requirements under German law which are merely based on the status of the Relevant Clearing Member having its place of establishment, incorporation or registration Germany.

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?*

Please see above in paragraph 3.2.2 applicable provisions of German law as regards the enforcement of a security interest governed by English law in particular in Insolvency Proceedings.

3.4 *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*.

We are not aware of any such issues but we are happy to look into this again upon further guidance on the issues you are looking for.

3.5 Settlement Finality

This section is concerned with the impact on finality of settlement of transfers of funds or securities (or both) from a Relevant Clearing Member to LCH in the event of that Relevant Clearing Member entering Insolvency Proceedings or becoming subject to Reorganisation Measures.

3.5.1 *If 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 analyses 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 EU Settlement Finality Directive?*

As regards the definition of Systems and whether it applies to third country central counterparties, please refer to paragraph 3.2.1(h)(ii) above. As mentioned under paragraph 3.2.1(a) above, upon the opening of Insolvency Proceedings the insolvent Relevant Clearing Member's right to manage and transfer the insolvency estate is vested in the Insolvency Administrator (section 80 InsO). Any dispositions of the insolvent Relevant Clearing Member over its property made after the opening of Insolvency Proceedings are void unless the relevant insolvency court otherwise orders (section 81 para 1 InsO). Section 340 para 3 InsO (paragraph 3.2.3(b)(iii)) provides that the effects of Insolvency Proceedings on the rights and obligations of participants in a System within the

meaning of section 1 para 16 KWG are governed by the laws of the state which applies to that System. We believe that also the prohibition of making any dispositions under section 81 para 3 InsO would be an effect of Insolvency Proceedings and, hence, be covered by the insolvency conflict of law provision under section 340 para 3 InsO.

With respect to settlement finality, section 81 para 3 InsO clarifies that if the Insolvent Party has transferred an asset forming part of the insolvency estate on the day on which the Insolvency Proceedings were opened, such transfer shall be presumed to have been effected after the opening of the Insolvency Proceedings. However, any transfer by the Insolvent Party in respect of Financial Collateral following the opening of Insolvency Proceedings is, notwithstanding the provisions on challenge in insolvency, legally valid if it occurred on the day of the opening and the other party proves that it was neither aware of nor had to be aware of the opening of the Insolvency Proceedings.

In Insolvency Proceedings specific conflict of laws provisions apply with respect to rights and obligations of participants in Systems (section 340 para 3 InsO (paragraph 3.2.3(b)(C)). Within the scope of application of the InsO, exemptions for Systems apply with respect to insolvency related set-off (paragraph 3.2.3(i)(v)) and the enforcement of security (paragraph 3.2.2(c)(ii)). Such exemptions apply analogously to measures under section 46 para 1 sentence 2 no. 4 to 6 KWG (section 46 para 2 sentence 6 KWG). Systems are also protected under sections 82 para 2, 83 para 3 and 84 para 4 SAG (paragraph 3.2.1(d)(iv)(F)). When implementing measures under the SRMR, the Resolution Authority needs to ensure that the safeguards provided for in BRRD are complied with when implementing decisions under the SRM (paragraph 3.2.1(d)(iv)(A)). This includes the aforementioned provisions under the SAG.

3.5.2 *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?

Please refer to our answer to paragraph 3.2.1(a) above, as section 81 para 3 InsO covers both, transfer of payments and delivery of securities.

3.5.3 *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.*

Please refer to paragraph 3.2.1(g) above with respect to exemptions for Financial Collateral and to paragraph 3.2.1(h) with respect to any exemptions applicable to Systems.

4. QUALIFICATIONS

4.1 Even where a German court would normally have to recognise the choice of the laws of England to govern the contractual obligations under the Opinion Documents, it may,

4.1.1 give effect to mandatory provisions of the law of the country where the obligations arising out of the Opinion Documents have to be or have been performed, insofar as those overriding mandatory provisions render the performance of the contract unlawful (Article 9 para 3 Rome I);

4.1.2 apply overriding mandatory provisions of German law (Article 9 para 2 Rome I) irrespective of the choice of the laws of England for the Opinion Documents;

4.1.3 refuse to apply the laws of England to the Opinion Documents, to the extent the application of the laws of England is manifestly incompatible with German public policy (Article 21 Rome I);

4.1.4 have regard to the law of the country in which performance takes place in relation to the manner of performance and the steps to be taken in the event of defective performance (Article 12 para 2 Rome I);

4.1.5 apply the provisions of the law of another Member State which cannot be derogated from by agreement, if all elements relevant to the situation at the time

that the Opinion Documents were entered into were located in a Member State other than England (Article 3 para 3 Rome I); and

4.1.6 apply mandatory provisions of EU law, if all elements relevant to the situation at the time that the Opinion Documents were entered into were located in one or more Member States (Article 3 para 4 Rome I).

4.2 The German law principle of *Treu und Glauben* (section 242 BGB) requires that contracts are performed in good faith. Actions *contra bonos mores* may provide certain rights in favour of a contracting party or may render contracts or commitments void or voidable. In addition, public policy may lead to "equitable" rights being upheld in German courts or may make contracts or commitments void or voidable or may lead to the re-characterisation of such contracts or commitments and German courts may declare provisions providing for strict liability invalid.

4.3 If a party is substantially over-collateralised, a security interest governed by German law can be void in case of an initial over-collateralisation for being contrary to public policy (section 138 para 1 BGB).[186] If over-collateralisation occurs subsequently, the secured party is required to release part of the security it has provided. Whether or not a party is substantially over-collateralised generally depends on the relation of the value of the secured obligation towards the realisable value of the collateral.[187]

However, if a security interest is governed by non-German law, German courts would only in exceptional cases not recognise the security interest by reason of over-collateralisation. Even if the granting of collateral results in a substantial over-collateralisation of the secured party by German standards, this does not necessarily

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[186] BGH NJW 1998, 2047. The BGH has not yet given any guidance as to when initial over-collateralisation would be considered as "substantial" and therefore void under section 138 para 1 BGB.

[187] Pursuant to the BGH (NJW 1998, 671, 674) the claim for release of security is triggered once the realisable value of the collateral not only temporarily exceeds the value of the secured obligation by 10 per cent. The BGH further stated that even if an agreement whereby a security transfer is effected does not provide for provisions on the release of the collateral, the debtor has an inherent claim for release if a (subsequent) over-collateralisation has occurred. Therefore, such security interest should not be void due to a substantial over-collateralisation (however, this does not apply in case of an initial over-collateralisation); the secured party would only be obliged to return the excess collateral. The same applies to the release of a pledge. We are not aware of any judgment according to which this also applies where collateral is provided by way of a outright title transfer. In case of a pledge under German law, an over-collateralisation should not occur because due to the accessory nature of a pledge, the pledge only exists in the amount of the secured obligation (including any future obligation). However, if pledged assets have been transferred to the pledgee or a third party (for example, a depository), the pledgor may request the return of such assets which are not subject to the pledge anymore.

lead a German court to conclude that the security interest is in breach of German public policy and that such security interest can therefore not be recognised under Article 21 Rome I or Article 6 EGBGB, as the case may be (i.e. the standards for assessing any infringement of German public policy are not the same under section 138 para 1 BGB as under Article 21 Rome I or Article 6 EGBGB[188]). We are not aware of any court precedents supporting the application of the *ordre public* in such case.

4.4 The general terms and conditions of German banks ("**AGB-Banken**") as published by the Association of German Private Banks (*Bundesverband deutscher Banken*) are frequently used by private Credit Institutions. Where the AGB-Banken govern a business relationship with a Credit Institution, any account maintained with the Credit Institution will usually be subject to a first ranking account pledge created in favour of the bank. Even where the AGB-Banken are not used, similar general terms and conditions are most likely to be in place when dealing with a Credit Institution and possibly when dealing with a Financial Services Institution. Similar restrictions may apply under general business conditions used by savings banks and cooperation banks. For purposes of this Opinion Letter, we have only reviewed the Opinion Documents and only expressed opinions on the Opinion Documents without taking into consideration further documents which may have an impact on our analysis.

4.5 By virtue of Article VIII section 2(b) of the Articles of Agreement of the International Monetary Fund (in connection with the German IMF Accession Act (*IWF-Beitrittsgesetz*) and the IMF Act (*IWF-Gesetz*)), as interpreted and applied by German courts, any obligation which involves the currency of any member of the International Monetary Fund and which is contrary to the exchange control regulations of that member may not be enforceable (*unklagbar*) in the German courts.

4.6 Any transfer of rights or payment in respect, or other performance, of an obligation under the Opinion Documents involving the government of any country which is currently the subject of United Nations or EU sanctions, any person or body resident in, incorporated in or constituted under the laws of any such country or exercising public functions in any such country or any person or body controlled by any foregoing or by any person acting on behalf of any of the foregoing may be subject to restrictions pursuant to such sanctions as implemented in German law.

4.7 In respect of cross-border cash payments the notification requirements under the German Foreign Trade Act (*Außenwirtschaftsgesetz*) and the German Foreign Trade

[188] *v. Hein*, in*:* Münchener Kommentar BGB, 8th ed. (2021), Article 6 EGBGB nos. 141 *et seqq.*; *Mülbert/Bruinier*, WM 2005, 105, 100. The BGH has not yet given any guidance as to when initial over-collateralisation would be considered as "substantial" and therefore void under section 138 para 1 BGB.

Regulation (*Außenwirtschaftsverordnung*) need to be observed. The reports have to be submitted to the Deutsche Bundesbank using the applicable notification forms. Any failure to comply would, however, not affect the validity of the respective transaction.

4.8 We do not express any opinion on data protection requirements or on German law principles governing bank secrecy.

4.9 We express no opinion as to whether any party has complied with any applicable provisions of Title II EMIR, any delegated or implementing acts adopted under EMIR, the provisions KWG, the German Securities Trading Act (*Wertpapierhandelsgesetz*) or the German Exchange Act (*Börsengesetz*) which were amended or enacted to implement EMIR, or any regulations adopted thereunder in respect of anything done by it in relation to or in connection with the Opinion Documents other than provisions on which we expressly opine. However, Article 12 para 3 EMIR provides that any infringement of the rules under Title II EMIR "shall not affect the validity of an OTC derivative contract or the possibility for the parties to enforce the provisions of an OTC derivative contract", consequently any failure by a party to so comply should not make the Opinion Documents invalid or unenforceable.

4.10 We express no opinions as to whether any party has complied with any applicable provision of Regulation (EU) No 2015/2365 of the European Parliament and of the Council of 25 November 2015 on transparency of securities financing transactions and of reuse and amending Regulation (EU) No 648/2012 ("**SFTR**").[189] Article 15 SFTR imposes obligations relating to rights of reuse where these are exercised. The SFTR has entered into force on 12 January 2016. Article 15 SFTR has taken effect from 13 July 2016 onwards.

4.11 We express no opinions on Regulation (EU) No 2016/1011 of the European Parliament and of the Council of 8 June November 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014 ("**Benchmark Regulation**").[190]

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[189] OJ EU No L 337 of 23 December 2015, p. 1.

[190] OJ EU No L 171 of 29 June 2016, p. 1. The Benchmark Regulation was amended by Regulation (EU) 2019/2089 of the European Parliament and of the Council of 27 November 2019 amending Regulation (EU) 2016/1011 as regards EU Climate Transition Benchmarks, EU Paris-aligned Benchmarks and sustainability-related disclosures for benchmarks (OJ EU No L 317 of 9 December 2019, p. 17).

4.12 Credit Institutions established as public law entities

4.12.1 Any set-off against a claim of a Credit Institution which is established as a public law entity is only permissible if payment is to be attributed to the same fund (*Kasse*) (i.e. where the entity has an administrative sub-division administering its own budget) of such German public law entity from which the claim of the party intending to effect the set-off is to be paid (section 395 BGB).

4.12.2 Credit Institutions which are established as public law entities may enter into contracts under private law where this is not expressly prohibited. However, where they engage in commercial acts under private law they are bound by the general restrictions applicable to German public law entities. In particular, they are bound by the fundamental rights (*Grundrechte*) of the German Constitution and the rule of law (*Rechtsstaatsprinzip*). On the facts of each individual case, the German courts may therefore reach the conclusion that general restrictions of Credit Institutions under public law prevent them from entering into certain types of transactions or oblige to refrain from exercising certain rights or to exercise their rights in a certain manner.

4.12.3 Under the German public law doctrine of ultra vires, the power and capacity of a legal entity established under public law to validly enter into a legally binding agreement under private law is limited. Public law entities may principally only enter into transactions that fall within their scope of competence (*Verbandskompetenz*) and functions (*Wirkungskreis*) as defined by the laws establishing or applicable laws conferring its powers and capacities upon such public law entity.[191] If a public law entity purports to enter into a contract under private law that is beyond or exceeding its functions, such a contract might be considered ultra vires and, therefore, void.[192] Provided that the ultra vires doctrine is applicable, it applies regardless of the good faith of the counterparty or any representation by the public law entity to the contrary. As a rule, ultra vires measures are unenforceable. They may not be ratified.

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[191] BGH NJW 1956, 746, 747; BGH NJW 1969, 2198, 2199; OVG Lüneburg NVwZ-RR 2010, 639, 641.

[192] BGH NJW 1956, 746, 747 *et seq*.; *Gurlit*, in: Erichsen/Ehlers, Allgemeines Verwaltungsrecht, 14th ed. (2010), § 31 no. 5. Pursuant to a judgement of the BGH of 28 April 2015 (XI ZR 378/13), the doctrine of *ultra vires* is, however, not applicable if a municipality enters into a derivatives agreement in breach of its own budgetary restrictions.

4.12.4 It is often argued that public sector entities are subject to a prohibition on speculation even though the legal basis of such prohibition is very unclear.[193] The prohibition on speculation would prevent public sector entities from entering into transactions for speculative purposes. In the absence of a clear legal basis or this principle the position of German courts has been that the prohibition on speculation – irrespective of the question whether and to what extent it constitutes a rule of law – would not lead to the voidness of contracts under section 134 BGB.[194]

4.12.5 Budgetary provisions are under German law considered to constitute internal law of the relevant public sector entity meaning that the violation of the budgetary laws does not affect the dealings with third parties.[195] In particular, it would not make contracts void under section 134 BGB which provides for the voidness of contracts violating a legal prohibition (*Verbotsgesetz*). However, under extraordinary circumstances the violation of budgetary provisions may make agreements entered into by a public sector entity void.

4.12.6 There is also considerable uncertainty as to whether a principle of connectivity (*Konnexität*) applies in respect of derivatives entered into by public sector entities.[196] The principle of connectivity would require such entities to only enter into transactions to hedge against certain risks from underlying contracts which the transaction matches.

4.12.7 In one case, a German court has argued that Credit Institutions may be under an obligation to inform a public sector entity of its restrictions under public law prior to the entry into a derivative and, failing to do so, that it may be liable to pay damages for wrongful investment advice.[197]

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[193] OLG Bamberg BKR 2009, 288, 292.

[194] OLG Naumburg NJOZ 2005, 3420, 3425; LG Düsseldorf, judgment of 11 May 2012 – 8 O 77/11.

[195] German Federal Constitutional Court (*Bundesverfassungsgericht*, "**BVerfG**"), BVerfGE 20, 56, 89 *et seq.*; *Kirchhof*, NVwZ 1983, 505, 506.

[196] *Endler*, in: Zerey, Finanzderivate, 4th ed. (2016), § 30 nos. 22 *et seq.*

[197] OLG Naumburg NJOZ 2005, 3420, 3427 *et seq.*

5. **RELIANCE**

5.1 This Opinion Letter is addressed to and solely for the benefit of LCH ("**Addressee**").

5.2 We accept responsibility to the Addressee in relation to the matters opined on in this Opinion Letter but the provision of this Opinion Letter is not to be taken as implying that we assume any duty or liability to the Addressee in relation to the Documents or the content of the Documents and the commercial and financial implications arising from them.

5.3 This Opinion Letter may be relied upon only by the Addressee and for the purposes of the Documents and, except with our prior written consent or where required by law or regulation, is not to be:

5.3.1 transmitted or disclosed to or used or relied upon by any other person, save that a copy of it may be disclosed, on a confidential and non-reliance basis and for information purposes, to the Addressee's affiliates and auditors for information purposes only and solely on the basis that we assume no responsibility to any such parties as a result of such disclosure; or

5.3.2 used or relied upon for any other purpose.

5.4 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. We consent to a copy of this Opinion Letter being made publicly available on the Adressee's website, for information purposes only and solely on the basis that we assume no responsibility to any other party as a result or otherwise.

Yours faithfully,

Dr. Marc Benzler

CLIFFORD CHANCE PARTNERSCHAFT MIT BESCHRÄNKTER BERUFSHAFTUNG

APPENDIX A

Section 104 InsO (incorporating the amendments in Article 2 of the the Third Insolvency Code Amendment Act) - This version applies to Insolvency Proceedings opened from 29 December 2016 onwards

§ 104

Fixed Date Transactions, Financial Transactions, contractual close-out netting

(1) In the event that a particular time or period was agreed upon for delivery of commodities (*Waren*) with a market or exchange price, and such time occurs or such period lapses after the opening of insolvency proceedings, specific performance may not be demanded, but rather only a claim for non-performance may be asserted. This also applies to financial transactions which have a market or exchange price, and for which a particular time or period was agreed which only occurs or expires after the opening of insolvency proceedings. Financial transactions shall include in particular

1. delivery of precious metals,

2. delivery of financial instruments or comparable rights, except where there is an intention to acquire an interest in another enterprise with the aim of establishing a long-term relationship with that enterprise,

3. payments of money

   a) which are to be made in a foreign currency or in a mathematical unit, or

   b) the amounts of which are calculated, directly or indirectly by referencing to the exchange rate of a foreign currency or a unit of account, to the interest rate for borrowings or to the price of other goods (*Güter*) or services,

4. deliveries and payments from derivative financial instruments not excluded pursuant to number 2 above,

5. options and other rights to demand delivery pursuant to sentence 1 or for delivery, payment or options and rights within the meaning of numbers 1 to 5 above,

6. financial collateral within the meaning of section 1 para 17 Banking Act .

Financial instruments within the meaning of sentence 3 numbers 2 and 4 are those instruments listed in Annex I Section C of Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (OJ. L 173 of 12.6.2014, p. 349; L 74 of 18.3.2015, p. 38; L 188 of 13.7.2016, p. 28), as last amended by Directive (EU) No 2016/1034 (OJ. L 175 of 30.6.2016, p. 8).

(2) The amount of any claim for non-performance shall be determined on the basis of the market or exchange value of the transaction. The market or exchange value is deemed to be

1. market or exchange price for a replacement transaction which is concluded without undue delay, but no later than on the fifth business day after the opening of insolvency proceedings, or

2. if no replacement transaction is entered into in accordance with number 1, the market or exchange price for a replacement transaction, that could have been concluded on the second business day after the opening insolvency proceedings.

To the extent that the market conditions do not allow for the conclusion of a replacement transaction pursuant to sentence 2 numbers 1 or 2, the market or exchange value is to be determined by way of methods and procedures allowing for an adequate assessment of the value of the transaction.

(3) Where transactions pursuant to paragraph 1 are combined in a master agreement or the rules of a central counterparty within the meaning of Section 1 paragraph 31 of the German Banking Act, which provides that the covered transactions may, upon the occurrence of certain events, only be terminated in their entirety, then the whole of such covered transactions shall be deemed to be a single transaction within the meaning of paragraph 1. This shall also apply, if other transactions are covered by such agreement or rules; such transactions shall be subject to the general provisions.

(4) The parties to the contract may agree deviating provisions as long as these are compatible with the fundamental principles applicable to the relevant statutory provision which is to be amended. They may, in particular, agree that,

1. the effects of paragraph 1 may apply prior to the opening of proceedings, in particular upon the application by a party to the contract for the opening of insolvency proceedings over its assets or upon the existence of a reason for the opening for proceedings (contractual termination),

2. that a contractual termination will encompass also such transactions pursuant to paragraph 1) in respect of which the claim for delivery of the commodities (*Waren*) or the performance of the financial transaction becomes due prior to the opening of proceedings, but after the point in time agreed for the contractual termination,

3. that for the purposes of the determination of the market or exchange value of the transaction

   a) the point in time of the contractual termination applies instead of the point in time of the opening of insolvency proceedings,

   b) the entering into of the replacement transaction pursuant to paragraph 2, sentence 2, number 1 may occur until the 20th business day after the contractual termination, if this is required to ensure that the unwinding of the transaction is performed in a manner that will maximise value,

   c) instead of the point in time specified in paragraph 2 sentence 2, number 2 a point in time or a period between the contractual termination and the expiry of the fifth business day following such termination shall apply.

(5) The other party may assert the claim for non-performance only as an insolvency creditor.

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Appendix 1 – Clearing Membership Agreement

Appendix 2 – Security Deed

Appendix 3 – Deed of Charge