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**ITALIAN LAW OPINION GIVEN IN
CONNECTION WITH THE CLEARING SERVICES
OF LCH LTD**

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Responses to Instructions to Counsel – Membership, Insolvency, Security, Set-off & Netting and Client Clearing following Brexit

Dear Sirs,

You have asked us to give an opinion in respect of Italian law in response to certain specific questions raised in by LCH Limited ("**LCH**") in relation to membership, insolvency, security, set-off & netting and client clearing, and the impacts thereon resulting from the United Kingdom leaving the European Union with effect on 31 January 2020 at midnight further to the vote on Brexit in the referendum held on 23 June 2016 (subject to a transitional period expiring on 31 December 2021), and on the assumption that no agreement on the future of the relationships between the United Kingdom was entered on or prior to the end of the transitional period (including as regards any further transitory periods) such that on such date the United Kingdom is no longer a member State of the European Union (such event being commonly designated as "hard brexit").

The opinions in this opinion letter (the "**Opinion Letter**") are given by Studio Legale Associato in Associazione con Clifford Chance. Any term not otherwise defined in this Opinion Letter shall have the meaning ascribed to such terms in the relevant Opinion Document (as defined in paragraph 1.6 below).

1. TERMS OF REFERENCE

1.1 Our opinions are given in respect of Clearing Members which are either banks, financial intermediaries or investment firms, and all references to a "Relevant Clearing Member" in this Opinion Letter shall be construed accordingly. For these purposes:

1.1.1 a reference to a "bank" is a reference to an institution incorporated under the laws of Italy and licensed under article 14 of Legislative Decree no. 385 of 1 September 1993, as subsequently amended (the "**Consolidated Banking Act**");

1.1.2 a reference to a "financial intermediary" is a reference to an institution incorporated under the laws of Italy and licensed under article 106 of the Consolidated Banking Act; and

1.1.3 a reference to an "investment firm" is a reference to an institution incorporated under the laws of Italy and licensed under article 18 of

Legislative Decree no. 58 of 24 February 1998, as subsequently amended (the "**Consolidated Financial Act**").

- 1.2 The opinions given in this Opinion Letter are applicable to all Services other than those governed by the FCM Regulations, *i.e.* the FCM SwapClear Service, the RepoClear Service, the EquityClear Service, the LSE Derivatives Market Service, the ForexClear Service and the Listed Rate Service.
- 1.3 In this Opinion Letter:
 - 1.3.1 A reference to the "**Bankruptcy Law**" is a reference to royal decree no. 267 of 16 March 1942;
 - 1.3.2 a reference to "**Brexit**" is a reference to the event consisting in United Kingdom irrevocably and effectively ceasing to be a member state of the European Union, which took effect on 31 January 2020 at midnight, subject to a transitional period expiring on 31 December 2021;
 - 1.3.3 a reference to the "**BRRD**" is a reference to directive n° 2014/59/EU of the European Parliament and Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms;
 - 1.3.4 a reference to the "**Civil Code**" is a reference to the Italian *codice civile*;
 - 1.3.5 a reference to the "**Client Clearing Arrangements**" is a reference to the contractual arrangements by which a Relevant Clearing Member is bound to the default management procedures of LCH in respect of Client Contracts, constituted by the Relevant Clearing Member's Clearing Membership Agreement and the General Regulations, including the Client Clearing Annex of the Default Rules of LCH;
 - 1.3.6 a reference to a "**Client Contract**" is a reference to a Contract entered into for the account of a Clearing Client;
 - 1.3.7 a reference to the "**Collateral Arrangements**" is a reference to the security arrangements which govern the provision of Collateral (as defined in LCH's Rulebook) by a Relevant Clearing Member to LCH, constituted by the relevant executed Deed of Charge, the General Regulations of LCH (in particular those set out in Section 4 (*Collateral*) of the Procedures of LCH) and the relevant instruction(s) through LCH's Collateral Management System;
 - 1.3.8 a reference to the "**Collateral Directive Regime**" is a reference to Directive no. 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements (as amended) (the

"**Collateral Directive**"), as implemented into Italian law pursuant to Decree 170;

- 1.3.9 a reference to the "**Credit Institution WUD Regime**" is a reference to Directive no. 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the reorganisation and winding-up of credit institutions (the "**Credit Institution WUD**") as amended by the BRRD and as implemented into Italian law under the Consolidated Banking Act;
- 1.3.10 a reference to "**Decree 210**" is a reference to Legislative Decree no. 210 of 12 April 2001 ;
- 1.3.11 a reference to "**Decree 180**" is a reference to Legislative Decree no. 180 of 16 November 2015;
- 1.3.12 a reference to the "**Default Arrangements**" is a reference to the contractual arrangements by which a Relevant Clearing Member is bound to the default management procedures of LCH, constituted by the Relevant Clearing Member's Clearing Membership Agreement and the General Regulations, including the Default Rules of LCH;
- 1.3.13 a reference to the "**EEA**" is a reference to the European Economic Area;
- 1.3.14 a reference to "**EMIR**" is a reference to Regulation (EU) no. 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories;
- 1.3.15 a reference to the "**EU**" is a reference to the European Union;
- 1.3.16 a reference to the "**EU Insolvency Regulation**" is a reference to Regulation (EU) no. 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings;
- 1.3.17 a reference to the "**Finality Directive Regime**" is a reference to Directive no. 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems (as amended) (the "**Finality Directive**"), as implemented into Italian law pursuant to Decree 210;
- 1.3.18 a reference to "**Insolvency Proceedings**" is a reference to the proceedings referred to in paragraphs 3.2.1(a)(2), 3.2.1(b)(2) and 3.2.1(c)(2) of this advice;
- 1.3.19 a reference to the "**Insolvency Representative**" is a reference to a liquidator, administrator, administrative receiver or analogous or equivalent official in Italy;

- 1.3.20 a reference to the "**Judgments Regulation**" is a reference to Regulation (EU) no. 1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (as amended);
- 1.3.21 a reference to "**Law Decree 237**" is a reference to Law Decree no. 237 of 23 December 2016, as converted into law by means of law no. 15 of 17 February 2017;
- 1.3.22 a reference to "**MiFID**" is a reference to Directive no. 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments;
- 1.3.23 a reference to the "**Parties**" is a reference to LCH and a single Relevant Clearing Member to which this Opinion Letter applies, and a reference to a "**Party**" is a reference to either of them;
- 1.3.24 a reference to "**Pre-Insolvency Proceedings**" is a reference to the measures referred to in paragraphs 3.2.1(a)(1) and (3), 3.2.1(b)(1) and (3) and 3.2.1(c)(1) and (3) of this advice;
- 1.3.25 a reference to "**Resolution Measures**" is a reference to the measures referred to in paragraphs 3.2.1(a)(4) and (5), 3.2.1(b)(4) and 3.2.1(c)(4) of this advice;
- 1.3.26 a reference to the "**Rome I Regulation**" means Regulation (EC) no. 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations;
- 1.3.27 a reference to the "**Services**" is a reference to all Services listed in paragraph 1.2 and a reference to a "**Service**" is a reference to either of them;
- 1.3.28 unless the context otherwise requires, a reference to a "paragraph" is a reference to a paragraph of this Opinion Letter; and
- 1.3.29 headings are for ease of reference only and shall not affect interpretation of this Opinion Letter.
- 1.4 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.

- 1.5 In this Opinion Letter, references to the "**enforcement**" of the Collateral under the Deed of Charge and any cognate terms means the act of:
- 1.5.1 sale and application of proceeds of the sale of Collateral against monies owed; or
 - 1.5.2 appropriation of the Collateral,
- in either case in accordance with the provisions of the Deed of Charge.
- 1.6 For the purposes of preparing our opinions given in this Opinion Letter we have only reviewed the following documents (the "**Opinion Documents**"):
- 1.6.1 the General Regulations, Procedures, Default Rules, Settlement Finality Regulations and the Product Specific Contract Terms and Eligibility Criteria Manual published on LCH's website accessed by us on 31 December 2020 (the "**LCH's Rulebook**") and, where applicable, as amended by LCH self-certification letter to the Commodity Futures Trading Commission (the "**CFTC**") dated 15 March 2018;
 - 1.6.2 an unexecuted standard form template version of the Clearing Membership Agreement (as defined in the LCH's Rulebook) which is substantially in the form appended as Appendix 1 to this Opinion Letter (the "**Clearing Membership Agreement**");
 - 1.6.3 an unexecuted standard form template version of the deed of charge to be entered into between a Relevant Clearing Member and LCH in respect of all Charged Property transferred to LCH by that Relevant Clearing Member which is substantially in the form of the deed of charge set out in Appendix 1 to this Opinion Letter 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, the "**Agreements**"); and
 - 1.6.4 A copy of the decision of ESMA's board of supervisors dated 25 September 2020, whereby ESMA recognized LCH as a third-country CCP under Chapter 4 of Title III of EMIR following the occurrence of the scenario described in the preamble to this Opinion Letter as "hard brexit" (the "**ESMA Decision**").
- 1.7 We have reviewed the Opinion Documents in connection with the instructions to counsel provided as attachment to an email sent to us on 24 July 2018 (the "**Instructions**") and the Service Description (as defined in the Instructions).

- 1.8 This Opinion Letter is a formal statement of opinion as to Italian law in force as at 1 January 2021 (the "**Opinion Date**"), as set out in paragraph 3 (*Statement of opinion*) below. It is based on our understanding of the Opinion Documents, within the scope described in paragraphs 1.9 and 1.10, and is subject to the assumptions set out in paragraph 2 (*Assumptions*) and to the qualifications set out in paragraph 5 (*Qualifications*). Attention is drawn to the fact that we do not have updated, and have not been instructed to update, this Opinion Letter according to the state of Italian law since the Opinion Date.
- 1.9 The opinions given in this Opinion Letter are strictly limited to the specific questions raised by you as set out in paragraph 3 (*Statement of opinion*) below and do not extend to any other matters. We have assumed that any matters which are or could be material in the context of our delivery of this Opinion Letter have been disclosed to us.
- 1.10 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:
- 1.10.1 the validity and enforceability of any provisions of any Opinion Documents without prejudice to the statement of opinion in paragraph 3 (*Statement of opinion*) below;
 - 1.10.2 any liability to tax as a result of or in connection with the Services, or the tax treatment of any Contract, or the tax position of any party thereto;
 - 1.10.3 any matters of fact (including any calculations or mathematic methods or formulae, any economic or financial information or figure as well as the adequacy or the relevance of any orders of priority for payments) or the reasonableness of any statements of opinion or intention expressed in relation to any Service, including any facts, events or circumstances arising as a result of the execution of any related documents by the Parties or the performance of the Parties' obligations deriving therefrom;
 - 1.10.4 any laws of any jurisdiction other than Italy, including jurisdictions in which our firm has an office or correspondents;
 - 1.10.5 the recognition and enforcement of foreign judgments as well as choice-of-law matters, except for those choice-of-law considerations where they are necessary for the purposes of the matters discussed in the scope of this Opinion Letter;
 - 1.10.6 any prudential treatment of any Relevant Clearing Member's exposure to LCH (or any part thereof);
 - 1.10.7 the compliance of the Opinion Documents with the provisions of EMIR;
 - 1.10.8 the impact on the opinions expressed in this Opinion Letter of:

- (a) Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments amending Directive 2002/92/EC and Directive 2011/61/EU, dated 15 May 2014 ("**MiFID II**"), and its Italian implementation legislation;
- (b) Regulation (EU) no. 600/2014 of the European Parliament and of the Council on markets in financial instruments and amending Regulation (EU) No. 648/2012 on OTC derivatives, central counterparties and trade repositories dated 15 May 2014; and
- (c) the proposal for regulation of the European Parliament and of the Council on a framework for the recovery and resolution of central counterparties; and

- 1.11 We have not been responsible for advising any party to the Opinion Documents other than LCH for the purposes of this Opinion Letter.
- 1.12 This Opinion Letter is confined to matters of Italian law in force as at the Opinion Date (including any EU law applicable in Italy), as applied and interpreted according to Italian case law published as at the Opinion Date. We express no opinion on EU law as it affects or would be applied in any jurisdiction other than Italy.
- 1.13 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 Italian law (including, in particular, applicable case law), or the legal status of any party to the Services, or any other circumstance that occurs, or is disclosed to us, after the Opinion Date, which might have an impact on the opinions given in this Opinion Letter.
- 1.14 This Opinion Letter is given in respect of the laws of this jurisdiction in force as at the Opinion Date. Any reference or comments on legislative bills or proposals or any draft regulatory instruments (such as decrees, orders, *etc.*) which, on the date of this Opinion Letter, are or may be under discussion in Italy, are made for information purposes only.
- 1.15 In this Opinion Letter, some Italian legal concepts are expressed in English and not in Italian. The concepts concerned may not be identical to those described by the English terminology employed. Those concepts accordingly have the meaning that Italian law gives them, irrespective of whether they are accompanied by their translation into Italian.

2. **ASSUMPTIONS**

2.1 **Assumptions relating to the application of foreign laws in relation to the Agreements and each Contract**

We have assumed the following with regard to the application of foreign laws:

2.1.1 that the Agreements and each Contract are legal, valid, binding and enforceable against both Parties under their governing laws and that there are no provisions of the laws of any jurisdiction (apart from Italy) which would be contravened by the execution of the Agreements and each Contract; and

2.1.2 that the Deed of Charge creates a valid and perfected security interest over the Collateral under its governing law and the governing law where the Collateral is located, such security interest being enforceable against the grantor thereof and any third parties under such law.

2.2 **Assumption relating to the application of EMIR in relation to the Agreements and each Contract**

We have assumed that the Agreements and each Contract are fully compliant with the provisions of EMIR.

2.3 **Assumptions relating to both Parties**

We have assumed the following with regard to each Party:

2.3.1 that each Party is duly incorporated and has the capacity, power and authority under all applicable laws to enter into the Agreements and each Contract, to exercise its rights and to perform its obligations under the Agreements and each Contract and that each Party has taken all necessary steps to enter into, execute, deliver, be bound by and perform the Agreements and each Contract, and that such steps have not been revoked or superseded;

2.3.2 that each Party has obtained, complied with the terms of and maintained all authorisations, approvals, licences and consents and has otherwise complied with all applicable laws and regulations required to enable it lawfully to enter into and perform its obligations under the Agreements and the Contracts and to ensure the legality, validity, enforceability and admissibility in evidence of the Agreements and each Contract in Italy;

2.3.3 that each Party has entered into the Agreements and each Contract in good faith, for the benefit of each of them respectively, on arms' length commercial terms;

- 2.3.4 that the execution and performance of the Agreements and each Contract are in each Party's corporate interest;
- 2.3.5 that any determination due to be made by a Party in accordance with the Agreements will be made in a commercially reasonable manner;
- 2.3.6 that the obligations assumed under the Agreements and the Contracts are "mutual" between the Parties, in the sense that the Parties are each personally and solely liable as regards obligations owing by it and solely entitled to the benefit of obligations owed to it; accordingly, and without limitation, no opinion is expressed where a Relevant Clearing Member is acting as agent for another person, or is a trustee, or in respect of which a Relevant Clearing Member has a joint interest (including partnership) or in respect of which a Relevant Clearing Member's rights or obligations or any interest therein have been assigned, charged, attached, garnished or transferred (whether in whole or in part) whether unilaterally, by agreement or by operation of law or by order;
- 2.3.7 that all obligations arising under the Agreements and/or any Contract can only be settled through a payment in cash or a delivery of financial instruments;
- 2.3.8 that none of the provisions of the Agreements are affected by fraud or are pursuing a fraudulent purpose; and
- 2.3.9 that none of the Parties is entitled to claim in relation to itself or its assets immunity from suit, attachment, execution or other legal process.

2.4 **Assumptions relating to LCH**

We have assumed the following with regard to LCH:

- 2.4.1 that, before Brexit, for the purposes of the Finality Directive, the Services operated by LCH had been designated and notified to the European Commission as a settlement–delivery system for financial instruments by a state of which is a party to the agreement on the EEA (an "**EEA Member State**")¹ and qualify as a system under the law of such member state (an "**EEA System**");

¹ In this regard, we refer you to the list of settlement systems within the meaning of the Finality Directive which includes LCH as a UK securities settlement system: (<https://www.esma.europa.eu/regulation/post-trading/settlement#title-paragraph-5>).

2.4.2 that, post Brexit:

- (a) the EU legislation as it is applicable in the United Kingdom on the date of this Opinion Letter is embedded into the domestic legal system of the United Kingdom with no substantive change;
- (b) the Deed of Charge and the Security Deed constitute valid and enforceable financial collateral arrangements under English law and benefit from the provisions of the UK legislation having implemented the Collateral Directive in its current state on the date of this Opinion Letter;
- (c) LCH is not insolvent for the purposes of any insolvency law; and
- (d) the Agreements and each Contract have been entered into prior to the commencement of any insolvency procedure under the laws of any jurisdiction in respect of LCH; and

2.4.3 that the ESMA Decision has been validly adopted and has not been revoked, amended or superseded.

2.5 **Assumptions relating to the Relevant Clearing Member**

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

2.5.1 that the Agreements and each Contract are entered into, and any payment, delivery or transfer of Collateral is effected prior to the commencement of any Insolvency Proceedings against the Relevant Clearing Member. At such time, the Relevant Clearing Member: (i) is not subject to any Resolution Measure; and (ii) it is not insolvent, within the meaning of article 5 of the Bankruptcy Law;

2.6 **Assumptions relating to the Collateral**

We have assumed the following with respect to the Collateral:

2.6.1 that each Relevant Clearing Member has the capacity, power and authority to create the security interests constituted by the Collateral Arrangements;

2.6.2 that each Party, when posting Collateral pursuant to the Collateral Arrangements, has full legal title to such Collateral at such time, free and clear of any lien, claim, charge or encumbrance or any other interest of the posting party or of any third person;

2.6.3 that all Collateral transferred pursuant to the Collateral Arrangements is freely transferable and capable of being subject to the security interest provided for in the Collateral Arrangements and all acts or things required by the laws of any jurisdiction to be done to ensure the validity and

enforceability *vis-à-vis* third parties of such security interest will have been effectively carried out;

- 2.6.4 that the collateral securities transferred pursuant to the Deed of Charge (i) are constituted solely of book-entry securities within the meaning of article 2(1)(g) ("*book entry securities collateral*") of the Collateral Directive; (ii) are financial securities (*valori mobiliari*) within the meaning of article 1, paragraph 1-*bis* of the Consolidated Financial Act; and (iii) each investor interest arising thereunder is recorded in fungible book-entry form in an account maintained by a financial intermediary located in the United Kingdom;
- 2.6.5 that, at any time, LCH, acting as chargee under the Deed of Charge, maintains continued possession over the Charged Property;
- 2.6.6 that the provision of Collateral to LCH can be evidenced in writing or by electronic means and any other durable medium and that such evidencing permits the identification of the Collateral as such (provided that, for this purpose, it is sufficient to prove that the Collateral taking the form of book-entry securities has been credited to, or forms a credit in, the relevant account and that the cash Collateral has been credited to, or forms a credit in, a designated account); and
- 2.6.7 any enforcement of the Collateral will be made on normal market terms.

3. STATEMENT OF OPINION

3.1 Membership

General

Please opine on the ability of a Relevant Clearing Member to enter into the LCH Agreements and if there is anything which would prevent a Relevant Clearing Member from performing its obligations under the LCH Agreements. In particular, please can you answer the following:

- 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 LCH Agreements (including for the purpose of granting of security under the Deed of Charge)?**

The limitations imposed by the constitutional documents of the Relevant Clearing Member and the restrictions limiting the capacity of the legal representatives of a Relevant Clearing Member to enter into the Agreements on behalf of the Relevant Clearing Member are discussed in paragraph 3.1.3 below.

On the assumption that the Relevant Clearing Member is duly authorised to provide investment services as part of its license as a bank, a financial intermediary, or an investment firm, there are no specific statutory limitations or regulatory requirements which would limit the capacity of an appropriately authorised Relevant Clearing Member to enter into the Agreements for the purpose of providing clearing services.

3.1.2 Would LCH be deemed to be domiciled, resident or carrying on business in Italy 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?

LCH would not be deemed to be domiciled or resident in Italy by virtue of providing Clearing Services to an Italian Clearing Member. It can be seen as carrying on business in Italy in the sense that it provides clearing services to Italian residents, but, even so, it does not need a local license as long as it is duly authorized by the competent authority in its Member State of establishment in accordance with EMIR.

After Brexit, LCH will be authorised to provide clearing services to clearing members in Italy without being required to be licensed in Italy on the basis that it will have become a recognised central counterparty due to the operation of the ESMA Decision (a "3RCCP"). No further licensing requirements other than the recognition procedure provided for by article 25 of EMIR would thus be required under Italian law for the purposes of providing clearing services to Relevant Clearing Members.

Further, it is worth noting that, alongside EU central counterparties authorised under article 17 of EMIR, 3RCCP: (i) are eligible for mandatory clearing of OTC derivative contracts pursuant to article 4(3) of EMIR; and (ii) qualify as a "qualifying central counterparty" (or QCCP) under article 4(1)(88) of Regulation (EU) n° 575/2013 of the European Parliament and of the Council of 26 June 2013 ("CRR").

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

In terms of the documents that a Relevant Clearing Member should be required to provide, we would recommend the following:

- (a) an up to date copy of the company's by-laws;

- (b) a certificate of incorporation from the relevant chamber of commerce;
- (c) if the powers to enter into the Agreements are not already evidenced in the by-laws, a copy of the board resolution approving the specific transaction and authorizing the relevant signatory, or, if no deal-specific resolution is passed, copy of the board resolution delegating to the signatory the responsibility of the relevant area of activities under which the envisaged transaction will fall;
- (d) a copy of the signatory's identity document;
- (e) evidence that it is duly authorized in Italy as a bank, a financial intermediary or an investment firm.

If the signatories have all necessary powers to enter into the Agreements, but the execution of the Agreements falls outside the corporate object of the Italian Clearing Members, Article 2384, paragraph 2, of the Civil Code (in its extensive construction favored by most legal scholars) applies, pursuant to which, where a contract is entered into in the name and on behalf of a company by a duly authorized representative, then if the contract falls outside the scope of the company's corporate object it is nonetheless enforceable unless it is proven that the counterparty acted intentionally to the detriment of the company².

If, instead, the signatories lack the powers, the contract is always null and void.

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

No.

²

Note, however, that there is also case law to the contrary (decision of the Italian Supreme Court no. 20597/2010 – which gave rise to strong criticism by Italian scholars); in this instance, the court maintained that a contract falling outside a company's corporate object is always null and void.

3.2 Insolvency, Security, Set-off and Netting

3.2.1 **Please identify the different types of insolvency proceedings and pre-insolvency reorganisation, restructuring and/or resolution measures. Would any of these not be covered by those events entitling LCH to liquidate, transfer or otherwise deal with Contracts as provided for in Rule 3 and Rule 5 of the Default Rules? Are any other events or procedures not envisaged in Rule 3 and Rule 5 of the Default Rules relevant?**

(a) The only bankruptcy, composition, rehabilitation or other insolvency or reorganisation procedures to which an Italian Clearing Member which is a bank could be subject under the laws of this jurisdiction, and which are relevant for the purposes of this opinion letter, are as follows:

- (1) *amministrazione straordinaria* (extraordinary administration) under Articles 70 to 77 of the Consolidated Banking Act;
- (2) *liquidazione coatta amministrativa* (compulsory administrative liquidation) under Articles 80 to 97 of the Consolidated Banking Act;
- (3) *Misure di intervento precoce* (early intervention measures) under Article 69-octiesdecies et seqq. of the Consolidated Banking Act;
- (4) *Risoluzione* (resolution) in accordance with Decree 180.
- (5) *Rafforzamento patrimoniale* (recapitalisation) in accordance with Law Decree 237.

(b) The only bankruptcy, composition, rehabilitation or other insolvency or reorganisation procedures to which an Italian Clearing Member which is a financial intermediary could be subject under the laws of this jurisdiction, and which are relevant for the purposes of this opinion letter, are as follows:

- (1) *amministrazione straordinaria* (extraordinary administration) under Articles 70 to 77 of the Consolidated Banking Act;
- (2) *liquidazione coatta amministrativa* (compulsory administrative liquidation) under Articles 80 to 97 of the Consolidated Banking Act;
- (3) *Misure di intervento precoce* (early intervention measures) under Article 69-octiesdecies et seqq. of the Consolidated

Banking Act (but only if it is included within the consolidated supervision of a banking group);

- (4) *Risoluzione* (resolution) in accordance with Decree 180 (but only if it is included within the consolidated supervision of a banking group).
- (c) The only bankruptcy, composition, rehabilitation or other insolvency or reorganisation procedures to which an Italian Clearing Member which is an investment firm could be subject under the laws of this jurisdiction, and which are relevant for the purposes of this opinion letter, are as follows:
- (1) *amministrazione straordinaria* (extraordinary administration) under Article 56 of the Consolidated Financial Act;
 - (2) *liquidazione coatta amministrativa* (compulsory administrative liquidation) under Article 57 of the Consolidated Financial Act.
 - (3) *Misure di intervento precoce* (early intervention measures) under Article 69-octiesdecies et seqq. of the Consolidated Banking Act (but only if it is included within the consolidated supervision of a banking group);
 - (4) *Risoluzione* (resolution) in accordance with Decree 180 (but only if it is included within the consolidated supervision of a banking group).

We believe that no other events or procedures in addition to those envisaged in Rule 3 and Rule 5 of the Default Rules are relevant in respect of Relevant Clearing Members.

Protections from resolution measures

Article 65 of Decree 180 clarifies that Resolution Measures do not qualify as insolvency proceedings for the purposes of Decree 210, and accordingly, the Finality Directive Regime (whose implications are discussed in the remainder of this opinion) will not apply in respect of Resolution Measures. Upon the adoption of a Resolution Measures, therefore, an Italian court would enforce the provisions of the Clearing Membership Agreement exclusively in accordance with the Italian private international law rules, and in particular pursuant to the provisions of the Rome I Regulation. As a result, an Italian judge would apply English law (as the law of the contract), subject, however, to the restrictions set out under Decree 180.

In this connection, we note that, pursuant to Article 65 of Decree 180, as long as the substantive obligations under a contract, including payment and delivery obligations, and provision of collateral, continue to be performed, the adoption of Resolution Measures in respect of a party does not give the other party the right to exercise any termination, suspension, modification, netting or set-off rights.

Other provisions of Decree 180 (which provisions apply to all Resolution Measures other than those under paragraph 1.4(e) above) are capable of limiting the rights of a derivative counterparty, among which: (i) article 66, whereby the resolution authority has the power to suspend any payment or delivery obligations pursuant to any contract to which an institution under resolution is a party; (ii) article 67, whereby the resolution authority has the power to restrict the enforcement of security interests against an institution under resolution; and (iii) article 68, whereby the resolution authority has the power to temporarily suspend termination rights against an institution under resolution. However, the provisions of articles 66, 67 and 68 of Decree 180 are expressly disapplied in respect of contracts entered into within a payment or settlement system, or a central counterparty (the scope of the definition of 'central counterparty' is discussed in detail in the "After Brexit" section of this paragraph). Accordingly, the provisions do not apply to the contractual relationship between LCH and a Relevant Clearing Member. That said, article 65 would still apply, meaning that, as mentioned above, as long as the Relevant Clearing Member continues to perform its payment and delivery obligations, LCH could not apply the Default Rules on the sole basis that Resolution Measures have been adopted in respect of that Relevant Clearing Member.

We also note that, pursuant to article 54, and Article 60, paragraph 1(l) of Decree 180 (which apply to all Resolution Measures other than those under paragraph (a)(5) above), the resolution authority has the power to close-out outstanding derivatives (as defined under article 2 of EMIR) to which the institution under resolution is a party, for the purposes of writing down or converting the liability arising from the close-out. However, this power is not exercisable in respect of 'secured liabilities' as defined in Article 2, paragraph 1(rr) of Decree 180. Accordingly, as long as the Contracts are fully collateralized, the resolution authority would not have the power to close them out in the event that Resolution Measures are adopted against a Relevant Clearing Member.

Moreover:

(i) article 91 of Decree 180 prevents the transfer of some, but not all, of the rights and liabilities that are protected under a title transfer financial collateral arrangement, a set-off arrangement or a netting arrangement

between the institution under resolution and another person, and the modification or termination of rights and liabilities that are protected under such a title transfer financial collateral arrangement, a set-off arrangement or a netting arrangement through the use of ancillary powers;

(ii) article 92 of Decree 180 prevents the transfer of a secured liability unless the benefit of the security are also transferred, the transfer of the benefit of the security unless the secured liability is also transferred, or the modification or termination of a security arrangement through the use of ancillary powers, if the effect of that modification or termination is that the liability ceases to be secured;

(iii) under article 94 of Decree 180, the adoption of Resolution Measures shall not affect the operation of systems and rules of systems covered by Directive 98/26/EC, where the resolution authority: (a) transfers some but not all of the assets, rights or liabilities of an institution under resolution to another entity; or (b) uses its powers to cancel or amend the terms of a contract to which the institution under resolution is a party or to substitute a recipient as a party.

After Brexit

In terms of LCH losing the benefit of those protections which depend on LCH qualifying as a system under the Finality Directive Regime, please note the following commentary.

Article 10, paragraphs 5 and 5-bis of Decree 210 (as amended by means of Law no. 145 of 30 December 2018) read as follows:

"5. The Bank of Italy can extend the application of the provisions [of Decree 210] to Italian participants to systems [...] of a non-EU jurisdiction. In the case of systems for the execution of transfer orders [in respect of financial instruments], the resolution is adopted by agreement with Consob, subject to assessing whether it would be appropriate to first enter into arrangements with the competent authorities in the relevant non-EU jurisdiction.

5-bis. By way of derogation from paragraph 5, designated systems of a former EU Member State which leaves the Union without an agreement pursuant to article 50 of the EU Treaty, which are operated by managers licensed to the provision of the relevant services within the territory of the Republic pursuant to the laws applicable to them, will continue to qualify as designated systems for all purposes under the laws of this jurisdiction, up until the adoption of a resolution pursuant to paragraph 5, and in any event for no longer than twenty-one months after the time when treaties cease to be applicable to the relevant former Member State pursuant to article 50 of the EU Treaty".

The provision under paragraph 5-*bis* was introduced in anticipation of Brexit and, in particular, of a 'no deal' scenario. Given that a withdrawal agreement under article 50 of the EU Treaty was entered into on 24 January 2020, the 'no deal' scenario assumed by this provision did not materialize (notwithstanding that the withdrawal agreement does not address the applicability of the Finality Directive Regime within the UK). Accordingly, paragraph 5-*bis* is not applicable to LCH.

It follows that, whether LCH will continue to benefit from the protections afforded under the Finality Directive Regime even after Brexit depends on whether the Bank of Italy adopts a resolution pursuant to article 10, paragraph 5, of Decree 210, in respect of LCH). In this respect, we note that the Bank of Italy did indeed adopt such a resolution on 24 November 2020 (the "**BoI Resolution**"). Under the BoI Resolution, the Finality Directive Regime (as implemented by Decree 210) will continue to apply to LCH, on the condition that LCH continues to be recognized under article 25 of EMIR.

Moreover, LCH will continue to enjoy those protections which are available to any third parties (such as the protections under articles 54, 60, 91 and 92 of Decree 180), or to central counterparties (such as the protections under articles 66, 67 and 68 of Decree 180).

In greater detail, with respect to protections afforded to "central counterparties", we note that "central counterparty" is defined under Decree 180 as "*an entity referred to in article 2(1) of [EMIR]*". Under article 2(1) of EMIR, "*CCP means a legal person that interposes itself between the counterparties to the contracts traded on one or more financial markets, becoming the buyer to every seller and the seller to every buyer*".

Despite the literal tenor of Decree 180 (which suggests that any central counterparty benefits from the protections afforded thereunder, whether established within the EU or in a third country, and whether licensed or unlicensed), there is, nonetheless, some legal uncertainty as to the exact delineation of the concept of central counterparties³; however, we believe that, on balance, 3RCCPs should be included in the scope of central counterparties under the above definitions, because, on the one hand, as mentioned in paragraph 3.1.2 above, 3RCCPs shall be assimilated to EU central counterparties when it comes to the performance of the mandatory clearing obligation relating to such OTC derivatives which are subject to

³ In this respect, the proposal of the EU Commission of 23 November 2016 of a directive amending BRRD (Com(2016) 852 final) casts some doubt on whether 3RCCPs currently benefit from the resolution stay protection provisions (see recital (22) of the proposed directive and the proposed modifications notably to articles 69(4)(b) (Power to suspend certain obligations), 70(2) (Power to restrict the enforcement of security interests) and 71(3) (Power to temporarily suspend termination rights).

such obligation and the characterisation as QCCP under CRR and, on the other hand, in relation to the valuation of liabilities arising from derivatives, RTS 2016/1401 applies to both EU central counterparties and 3RCCPs.⁴ As a result, concluding that 3RCCPs do not benefit from the protection from the stay provisions of the BRRD would be inconsistent with: (i) the aforementioned RTS; and (ii) from an economic standpoint, with the fact that mandatory clearing is permitted through such central counterparties and institutions subject to CRR prudential requirements are authorised to apply to them the same risk weighting as is applicable to EU CCPs.

3.2.2 Would the Deed of Charge be effective in the context of Insolvency Proceedings or Pre-Insolvency Proceedings 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?

Validity

Under the Finality Directive Regime (article 7 of Decree 210), "*in the event of insolvency proceedings being opened against a member of a clearing system, the rights and obligations arising from, or in connection with, the participation of that member to the clearing system are governed by the law governing the system*". While this provision applies to the rights and obligations of the insolvent member *vis à vis* its counterparties, it is doubtful that it could also apply to *in-rem* rights, which are exercisable not only against the security provider, but also against third parties.

We believe, therefore, that the question whether the *in-rem* rights purported to be created by the Deed of Charge have been validly created falls to be governed by article 10 of Decree 170, whereby *in-rem* rights in respect of book-entry securities shall be governed by the law of the country in which the relevant account is maintained, i.e. English law in the case of the Deed of Charge, on the basis that the account in the name of the Relevant Clearing Member is opened with LCH in England (whereas the account with the central securities depository where the relevant securities are ultimately held is opened in the name of LCH). Notably, even if article 10 of Decree 170 was enacted as part of the implementation of the Collateral Directive Regime, this provision applies regardless of whether the security created over the relevant book-entry collateral qualifies as a 'financial collateral arrangement' for the purposes of the Collateral Directive Regime.

⁴ Commission delegated regulation (EU) n° 2016/1401 of 23 May 2018.

In the case of collateral in the form of cash, the Italian conflict of laws rules do not clearly identify the laws which apply to the *in-rem* rights attaching to a charge over cash in an account. In our view, there are arguments to maintain that the same principles applicable to securities should apply to cash collateral by way of analogy, in the absence of any other indication; accordingly, we believe that the criterion under article 10 of Decree 170 (which identifies the laws of the jurisdiction where the account is located as the governing law of the *in-rem* rights over the collateral in the account) should also apply to cash collateral.

Accordingly, upon the opening of Insolvency Proceedings or Pre-Insolvency Proceedings, an Italian court would recognize the validity of the *in-rem* rights created by the Deed of Charge to the extent that the Deed of Charge has been validly created and perfected under English law.

Enforcement

In terms of steps which LCH may need to take before enforcing the Deed of Charge, upon the opening of Insolvency Proceedings against a Relevant Clearing Member, the Bankruptcy Law would ordinarily require a secured creditor to first file a proof of claim in respect of any amounts owing to it, and then wait for court authorisation before enforcing the collateral.

However, please note the following mitigants.

Finality Directive Regime. Pursuant to article 8, paragraph 6, of Decree 210, no action, including an action for a declaration of nullity, can prejudice the realisation of margins acquired in the context of an EEA System. This provision certainly affords protection against the exercise of claw-back powers by an insolvency receiver; it is doubtful, however, whether it could also be invoked to by-pass the procedural requirements under the Bankruptcy Law.

Financial collateral arrangement. As long as the Deed of Charge qualifies as a financial collateral arrangement for the purposes of Decree 170, even after the opening of Insolvency Proceedings LCH would be able to enforce the Deed of Charge with no need to file a proof of claim or obtain prior court authorisation. Under Decree 170, "financial collateral arrangement" means a title transfer financial collateral arrangement or a security financial collateral arrangement (*pegno regolare*), including repo transactions, and any other arrangement relating to financial assets and designed to secure exposure under a financial obligation, where either:

- (i) both parties are public bodies, central banks or entities subject to prudential supervision; or
- (ii) one party is one of the entities listed in (i) and the other is a corporate entity (i.e. any entity other than an individual).

Moreover, for Decree 170 to apply, it is also required that the Collateral be placed in the possession or under the control of the Collateral Taker. There is no definition of either "possession" or "control" for the purposes of Decree 170. It is generally maintained that the collateral-taker may be regarded as having acquired 'possession or control' of the Collateral credited to the account only if the Collateral Provider is prevented from disposing of them. An Italian court will assess whether 'possession or control' exists in accordance with Italian law, i.e. by interpreting the provisions of Decree 170; accordingly, even if LCH is able conclude that the Deed of Charge does place the Collateral in the possession or under the control of the Collateral Taker as a matter of English law, this does not automatically entail that an Italian court will have to share the same view as a matter of Italian law; however, because Decree 170 constitutes local implementation of EU law – which needs to be construed consistently across all Member States – an Italian court would at least need to consider the reasoning which led to a positive conclusion in other EU jurisdictions.

Article 79-septies of the Consolidated Financial Act. Pursuant to article 79-septies, paragraph 1, of the Consolidated Financial Act, "*margins acquired by a central counterparty can be applied only in accordance with [EMIR]. The opening of insolvency proceedings against a participant does not prevent the adoption and effectiveness of the measures under article 48 [of EMIR] by the central counterparty, in accordance with such article, in order to handle the insolvent participant's positions and to port such positions and the relevant collateral, or to return the collateral to the clients, in accordance with such regulation. Such measures cannot be declared ineffective by virtue of the application of other provisions of the laws of this jurisdiction.*"

Accordingly, as long as the enforcement of the Deed of Charge occurs within the boundaries of article 48 of EMIR, one may try to argue that the provisions of article 79-septies of the Consolidated Financial Act should prevail over those provisions of the Bankruptcy Law which require prior filings and authorisations, as such provisions would stand in the way of the full effectiveness of the measures under article 48 of EMIR.

Credit Institution WUD Regime. Pursuant to article 95-ter, paragraph 1(d) of the Consolidated Financial Act, if Insolvency Proceedings or Pre-Insolvency Proceedings are opened against banks, financial intermediaries or investment firms, the effects of the opening of such Insolvency Proceedings or Pre-Insolvency Proceedings over book-entry securities are solely governed by the laws of the EU Member State where the account is located.

After Brexit

Finality Directive Regime

The Finality Directive Regime would continue to apply as long as the BoI Resolution remains in force, still subject to the uncertainty as to its actual availability in respect of the Deed of Charge as discussed in sub-sections "Validity" and "Enforcement" above, and further subject to the discussion in paragraph 3.2.1 above.

Financial collateral arrangement

The above analysis would remain unchanged. While it is doubtful whether "central counterparties" for the purposes of Decree 170 also include non-EU CCPs, we note that an arrangement can still qualify as a financial collateral arrangement under Decree 170 as long as at least one of the parties is an eligible party. In this connection, we note that a Relevant Clearing Member will always qualify as such.

Article 79-septies of the Consolidated Financial Act

The analysis would remain unchanged on the basis that LCH will be recognized under EMIR due to the operation of the ESMA Decision. This is because article 79-septies, paragraph 3 of the Consolidated Financial Act clarifies that the provisions in question also apply to non-EU CCPs, as long as they are recognized under EMIR.

Credit Institution WUD Regime

The protection under the Credit Institution WUD Regime ceases to apply, as such protection is limited to collateral credited to accounts located in a EU Member State.

Regarding the effects of Resolution Measures in this respect please refer to our observations set out in paragraph 3.2.1 above.

- 3.2.3 **Would LCH have the right to take the actions provided for in the Default Rules (including exercising rights to deal with Contracts under Rule 6 and rights of set-off under Rule 8 but not at this stage considering those actions specifically provided for in the Client Clearing Annex to the Default Rules) in the event that a Relevant Clearing Member was subject to Insolvency Proceedings or Pre-Insolvency Proceedings? Is it necessary or recommended that LCH should specify that certain Insolvency Proceedings and/or Pre-Insolvency Proceedings 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 Pre-Insolvency Proceedings to which the answer applies and briefly explain your reasoning.**

Article 7 of Decree 210 will apply upon the opening of Insolvency Proceedings; accordingly, whether LCH would be entitled to rightfully take the actions provided for by the Default Rules would be exclusively a matter of substantive English law, to which Italian law defers (please refer

to the detailed analysis in paragraph 3.3.3 below). We believe that it is not necessary to specify that certain Insolvency Proceedings and/or Reorganisation Measures constitute Automatic Early Termination Events.

In the case of Pre-Insolvency Proceedings, Decree 210 would not apply, unless a suspension of payments is ordered in the context the Pre-Insolvency Proceedings. However, Pre-Insolvency Proceedings do not entail any restrictions to contractual rights. In such circumstances an Italian court would enforce the provisions in question exclusively in accordance with the Italian private international law rules, and in particular pursuant to the provisions of the Rome I Regulation. As a result, an Italian judge would apply English law (as the law of the contract).

After Brexit

In the case of Pre-Insolvency Proceedings, the analysis remains unchanged.

In the case of Insolvency Proceedings, Decree 210 would continue to apply as long as the BoI Resolution remains in force; moreover, the following (more limited) protections continue to apply as well.

Under the Credit Institution WUD Regime.

With respect to a Relevant Clearing Member, in accordance with article 95-ter, paragraph 2, of the Consolidated Banking Act, netting agreements are exclusively governed by the law applicable to the contract governing such agreements and accordingly an Insolvency Proceeding would have no effect on such netting arrangements, without prejudice to the application of Resolution Measures (as to which please refer to paragraph 3.2.1 above). This provision is not limited to circumstances where the governing law is the law of an EU Member State; therefore, based on its literal tenor, this provision should be capable of being applicable to contracts governed by English law even after Brexit. Some degree of uncertainty remains, however, because the provision in question is aimed at implementing the Credit Institution WUD and, accordingly, there is a risk that such provision be interpreted (in a narrower manner) so as to only encompass the governing laws of EU Member States.

Under the Collateral Directive Regime

Close-out netting in respect of Contracts (also taking into account any posted collateral), as provided for in the Default Rules, will benefit from the Collateral Directive Regime to the extent the conditions set out in paragraph 3.3.2 are met.

Under the Consolidated Banking Act

Under article 83, paragraph 3-*bis*, of the Consolidated Banking Act, set-off cannot be invoked after the opening of Insolvency Proceedings, unless it is based on a voluntary set-off agreement pursuant to article 1252 of the Civil Code. Therefore, to the extent that the remedies under the Default Rules are characterized as a voluntary set-off agreement, they would be available article 83, paragraph 3-*bis*, of the Consolidated Banking Act even after the commencement of Insolvency Proceedings.

Conclusion

Before Brexit, LCH had the right, to the extent permitted by the relevant law applicable in respect of the Finality Directive Regime and the Credit Institution WUD Regime (*i.e.* English law), to take the actions provided for in the Default Rules (including exercising rights to deal with Contracts under Rule 6 and rights of set-off under Rule 8) in the event that a Relevant Clearing Member was subject to Insolvency Proceedings and/or Pre-Insolvency Proceedings.

After Brexit, such right should be preserved on the basis of the Finality Directive Regime (subject to the discussion in paragraph 3.2.1 above), the Collateral Directive Regime and the netting exception provided for by the Credit Institution WUD Regime, as well as, but with a higher degree of uncertainty, the set-off exception contemplated by the Consolidated Banking Act, but, in either case, only insofar as the actions provided for in the Default Rules pertain to termination and close-out of the Contracts.

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

It is a general rule of Italian insolvency law (known as *revocatoria fallimentare*), under Article 67, paragraph 2 of the Bankruptcy Law, that all payments, transactions or margin transfers made, and agreements entered into (including security arrangements entered into simultaneously with the creation of the secured obligations), by an insolvent company in the six-month period before the declaration of insolvency, are liable to be clawed back and set aside if the insolvency representative can prove that the beneficiary of such payment or margin transfer or the counterparty to such transaction or agreement, as the case may be, had actual or constructive knowledge at the time of the transaction of the state of insolvency of the company subsequently declared insolvent.

Moreover, pursuant to Article 67, paragraph 1 of the Bankruptcy Law, where a company has entered into a transaction or agreement at an undervalue (meaning that such company received materially less by way of consideration for an obligation undertaken by it to its contractual counterparty than it provided by way of consideration to its contractual counterparty) or has granted any security interest in respect of pre-existing obligations which at the time of granting of such security interest were not due and payable, in the one year period preceding the declaration of insolvency of such company, the transaction, agreement or security is liable to be clawed back and set aside unless the counterparty can prove that it had no actual or constructive knowledge of the state of insolvency of the company at the time the transaction was entered into or the security interest was granted. However, as long as Decree 170 applies, additional Collateral posted in accordance with margining provisions or substitution provisions would not be treated as security provided in respect of pre-existing obligations; instead, it would be treated as having been posted at the same time as the initial Collateral.

Where a company, during the one year period preceding the declaration of insolvency of such company, has granted a security interest in respect of pre-existing obligations which at the time of granting of such security interest were due and payable, such security interest is liable to be clawed back and set aside unless the counterparty can prove that it had no actual or constructive knowledge of the state of insolvency of the company at the time the security interest has been granted.

In the case of Resolution Measures, Article 67, paragraph 2 of the Bankruptcy Law does not apply. Article 67, paragraph 1 of the Bankruptcy Law applies, but only if the institution under resolution is declared insolvent in the context of the resolution, in which case the reasoning above will apply; that said, we believe that the Contracts are unlikely to be transactions of the type which would be captured under Article 67, paragraph 1 of the Bankruptcy Law (i.e. transactions at an undervalue); hence, in practice, it is unlikely, in our view, that the Contracts could be subject to claw back in the context of the adoption of Resolution Measures against a Relevant Clearing Member.

Protections under the Finality Directive Regime

Article 2, paragraph 3 of Decree 210 provides that no action, including an action seeking annulment, can be brought forward in prejudice of the finality of transfer orders, where 'transfer order' means "any instruction by a participant to place at the disposal of a recipient an amount of money by means of a book entry on the accounts of a credit institution, a central bank or a settlement agent, 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 by means of a book entry on a register, or otherwise". By virtue of this provision, any payments or deliveries made under a

Contract prior to the opening of Insolvency Proceedings appear to be shielded from the claw back regime. It is not clear whether the Contract itself also benefits from this protection, with the result that it could not be liable to be clawed back, not even with respect to the effects of the same that would have occurred after the opening of Insolvency Proceedings (i.e. future payments and deliveries). A Contract does not fall squarely within the definition of "transfer order", although it might be arguable that the submission of a transaction for clearing causes "the assumption of a payment obligation" upon the Relevant Clearing Member (namely, the obligation to exchange cash flows in accordance with the terms of the Contract). A broad interpretation of Article 2, paragraph 3 of Decree 210 and of the concept of "transfer order" could be advocated on the grounds that it would be consistent with the rationale of Decree 210 (and Directive 98/26/EC), i.e. to ensure that the insolvency of a participant to a system does not trigger disruptive consequences for the system, and we believe that this would indeed be the most reasonable interpretation; however, due to the literal tenor of the provisions in question, which do not seem to capture Contract in their entirety, it cannot be excluded that an insolvency representative may seek to claw back a Contract at least with respect to the effects it would have had after the opening of Insolvency Proceedings.

In this connection, we note that an Italian insolvency court would address the question of whether the Contract itself would be shielded from claw back on the basis of the Italian implementation of Directive 98/26/EC, i.e. Decree 210, rather than the equivalent provisions of English law (being the law governing the contractual relationship between LCH and the Relevant Clearing Member); therefore, even if the same question had a clear positive answer under English law that would not be relevant before an Italian court, and, accordingly, the above reasoning regarding the interpretation of Article 2 of Decree 210 would still apply.

As regards security arrangements supporting the obligations of a participant to a system, Article 8, paragraph 3, of Decree 210 provides that no action, including an action seeking annulment, can be brought forward in prejudice of the system's right to enforce the security; accordingly, the Italian insolvency claw-back regime should not apply in respect of the security granted by a participant to a system in connection with its participation to such system.

Protection under the Credit Institution WUD Regime

Another defence against claw-back could possibly stem from Article 30(1) of the Credit Institution WUD, as implemented under Article 95-ter, paragraph 4: this provision may provide a defence to a claw back action brought by an Italian liquidator if the creditor can prove that: (a) the act considered to be detrimental (i.e. the one which the liquidator is proposing to claw back) is subject to the law of another EU member state (i.e. English law in the case of the Contracts); and (b) that law (i.e. English law) does not allow any means of challenging that act in the relevant case.

If a Contract is clawed back in accordance with the above, it will be deemed as it had never been entered into; however, LCH may not be required to return any payments it received under the relevant Contract (as they should be regarded as transfer orders).

After Brexit

The protections afforded under the Credit Institution WUD Regime will no longer apply. However, the protections afforded under the Finality Directive Regime will continue to apply, subject to the discussion in paragraph 3.2.1 above, and accordingly: (i) any payments or deliveries made under a Contract prior to the opening of Insolvency Proceedings will be shielded from the claw back regime pursuant to Article 2, paragraph 3 of Decree 210; (ii) the Contract itself would also be shielded from the claw back regime pursuant to Article 2, paragraph 3 of Decree 210, if the broader interpretation of the concept of "transfer order" is followed; and (iii) security arrangements supporting the obligations of a participant to a system would be shielded from the claw back regime pursuant to, Article 8, paragraph 3, of Decree 210.

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

Both prior to and after Brexit, if LCH takes action under the Default Rules with respect to one or more Contracts to achieve a discharge of such Contracts, Italian law will recognise and give effect to such action to achieve a discharge of the Parties' rights and obligations under each such Contract and to calculate a net sum payable in respect of all such Contracts so discharged, for the reasons, and subject to the conditions and the limitations, set out in paragraph 3.2.3 above.

The same applies to the enforcement of the Deed of Charge in respect of Collateral located (or deemed to be located) in the same jurisdiction, for the reasons and subject to the conditions and the limitations, set out in paragraph 3.2.2.

Regarding the effects of Resolution Measures in this respect please refer to our observations set out in paragraph 3.2.1. above.

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

No, pursuant to Article 59 of the Bankruptcy Law any claims must be converted into local currency.

3.3 Client Clearing

- 3.3.1 **Please opine on the availability and effectiveness of any law, regulation or statutory provision (having the force of law) in Italy 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 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.

Pursuant to article 79-septies, paragraph 1, of the Consolidated Financial Act, "margins acquired by a central counterparty can be applied only in accordance with [EMIR]. The opening of insolvency proceedings against a participant does not prevent the adoption and effectiveness of the measures under article 48 [of EMIR] by the central counterparty, in accordance with such article, in order to handle the insolvent participant's positions and to port such positions and the relevant collateral, or to return the collateral to the clients, in accordance with such regulation. Such measures cannot be declared ineffective by virtue of the application of other provisions of the laws of this jurisdiction."

We believe that the above provision – which does not require the relevant margining arrangement to qualify as a 'financial collateral arrangement' under Decree 170 – qualifies as an Exempting Client Clearing Rule.

Default Outside Insolvency Proceedings or Pre-Insolvency Proceedings

- 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 Pre-Insolvency Proceedings in respect of that clearing member and (ii) seek to port the Client Contracts and Account Balance of a Clearing Client to a Backup Clearing Member as a result, could the Relevant Clearing Member or any other person successfully challenge the actions of LCH and claim for the amount of the Account Balance?**

In such circumstances an Italian court would enforce the provisions in question exclusively in accordance with the Italian private international law rules, and in particular pursuant to the provisions of the Rome I Regulation. As a result, an Italian judge would apply English law (as the

law of the contract), subject to the limitations set out in the Rome I Regulation.

In the case of Resolution Measures, please refer to the limitations under Article 65 of Decree 180, as discussed in paragraph 3.2.1 above. In this connection, we believe that the provisions allowing LCH to port the Client Contracts and the Account Balance to a Backup Clearing Member would be regarded as termination provisions for the purposes of Decree 180 and, as such, they could not be invoked by LCH solely as a consequence of Resolution Measures having been adopted against a Relevant Clearing Member, as long as that Relevant Clearing Member continues to perform its payment and delivery obligations.

After Brexit

The analysis remains unchanged.

- 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 Pre-Insolvency Proceedings 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?**

Our conclusion set out in paragraph 3.3.2 above equally applies *mutatis mutandis* to the return of the Client Clearing Entitlement to the relevant Clearing Client or to the Defaulter for the account of such client.

Insolvency-related Default

- 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?**

Article 7 of Decree 210 provides that "*in the event of insolvency proceedings being opened against a member of a clearing system, the rights and obligations arising from, or in connection with, the participation of that member to the clearing system are governed by the law governing the system*".

This provision implements Article 8 of the Finality Directive pursuant to which "*in the event of insolvency proceedings being opened against a participant in a system, the rights and obligations arising from, or in connection with, the participation of that participant shall be determined by the law governing that system*", which aims to protect the orderly operation and the finality of settlements in payment and clearing systems by allowing such a system to rely on its relevant governing law to determine the effects of the insolvency of a participant.

if Article 7 of Decree 210 was applicable to LCH, then 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, neither an insolvency officer appointed to the defaulting Relevant Clearing Member nor any other person could successfully challenge the actions of LCH and claim for the amount of the Account Balance to the extent that such challenge is not possible under substantive English insolvency law. It would follow that, to the extent that substantive English law gives effect to the relevant provisions of the Default Provisions in a manner that ensures the proper functioning of the relevant mechanisms as envisaged in the Default Rules (which, we understand, would be the case), Article 7 of Decree 210 would, in our view, prevent Italian law (including Italian insolvency law) from interfering with the operation of the relevant provisions of the Default Rules in accordance with substantive English law.

After Brexit

The protection under the Finality Directive Regime – whereby in the event of Insolvency Proceedings being opened against a Relevant Clearing Member, the rights and obligations arising from, or in connection with, the participation of that Relevant Clearing Member to LCH would be governed solely by English law – would continue to be available, subject to the discussion in paragraph 3.2.1 above. Moreover, we are of the view that LCH would be able to port the Client Contracts and Account Balance of a Clearing Client to a Backup Clearing Member also by virtue of the operation of the Exempting Client Clearing Rule referred to in paragraph 3.3.1 above.

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

successfully challenge the actions of LCH and claim for the amount of the Client Clearing Entitlement?

The analysis referred to in paragraph 3.3.4 above would apply, *mutatis mutandis*. Accordingly, LCH could return the Client Clearing Entitlement to the relevant Clearing Client or to the Defaulter for the account of such client: (i) prior to Brexit, on the basis of the provisions of Article 210 of Decree 210; and (ii) after Brexit, by virtue of the operation of the Exempting Client Clearing Rule referred to in paragraph 3.3.1 above.

Pre-Insolvency Proceedings

3.3.6 If: (i) following the implementation of Pre-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 the representative appointed to reorganise/manage the Defaulter or any other person successfully challenge the actions of LCH and claim for the amount of the Account Balance?

In the event that a Relevant Clearing Member is subject to Pre-Insolvency Proceedings, the contractual provisions of the Clearing Membership Agreement would normally apply in accordance with their terms (provided that they are enforceable under English law) as pre-insolvency scenarios would be, subject to the analysis below, regarded as non-insolvency scenarios for the purposes of the participation to a system.

In such circumstances, therefore, an Italian court would enforce the provisions in question exclusively in accordance with the Italian private international law rules, and in particular pursuant to the provisions of the Rome I Regulation.

The above reasoning would not apply should Pre-Insolvency Proceedings be initiated against a Relevant Clearing Member that fall within the definition of "insolvency proceedings" within the meaning of Article 1(p) of Decree 210.

Pre-Insolvency Proceedings are not per se such that they would be regarded as "insolvency proceedings" pursuant to Decree 210. However, it is possible that a suspension of payments be ordered pursuant to article 74 of the Consolidated Banking Act if, in the opinion of the pre-insolvency administrator, exceptional circumstances exist requiring such a measure to protect the interests of the creditors. Should this be the case, then the relevant Pre-Insolvency Proceeding would qualify as an insolvency

proceeding for the purposes of Decree 210 and accordingly an Italian court would apply article 7 of Decree 210; in which case the analysis under paragraph 3.3.4 above will apply.

After Brexit

The above analysis will still apply.

- 3.3.7 **If: (i) following the commencement of Pre-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 the representative appointed to reorganise/manage the Defaulter or any other person successfully challenge the actions of LCH and claim for the amount of the Client Clearing Entitlement?**

The conclusions set out in paragraph 3.3.6 above equally applies in such circumstances.

General

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

There are no other material issues relevant to the issues addressed in this Opinion Letter which we wish to draw to your attention to.

4. SETTLEMENT FINALITY

Overview

- 4.1 **This section is concerned with the impact on the finality of settlement of a Payment Transfer Order or Securities Transfer Order (or both), including the corresponding transfer of funds or securities, respectively, from a Relevant Clearing Member to LCH through a Settlement Services Provider or PPS Bank (or both) in the event of that Relevant Clearing Member entering Insolvency Proceedings or becoming subject to Pre-Insolvency Proceedings.**

Question

- 4.2 **Would the commencement of Insolvency Proceedings in respect of a Relevant Clearing Member affect the finality of settlement of a Payment Transfer Order, including the corresponding transfer of funds, from the Relevant**

Clearing Member to LCH through a Settlement Services Provider or PPS Bank (or both)? If so, please clarify from which point in time and in which circumstances finality protections in respect of such settlement would be lost.

See the commentary under section "*Protections under the Finality Directive Regime*" of paragraph 3.2.4 above.

- 4.3 **Would the commencement of Insolvency Proceedings in respect of a Relevant Clearing Member affect the finality of settlement of a Securities Transfer Order, including the corresponding transfer of securities, from the Relevant Clearing Member to LCH through a Securities System Operator? If so, please clarify from which point in time and in which circumstances finality protections in respect of such settlement would be lost.**

See the commentary under section "*Protections under the Finality Directive Regime*" of paragraph 3.2.4 above.

- 4.4 **Are there any circumstances (such as the commencement of Pre-Insolvency Proceedings) 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.**

See the commentary under section "*Protections from resolution measures*" of paragraph 3.2.1 above.

5. **QUALIFICATIONS**

5.1 **Effectiveness of Security**

5.1.1 We express no opinion as to:

- (a) whether a Relevant Clearing Member has good legal or other title to the assets or rights which are expressed to be subject to a security interest, or as to the existence or value of any such assets or rights; or
- (b) whether any security interest constitutes a legal or equitable security interest or a fixed or specific (rather than a floating) charge.

5.1.2 Our opinions are subject to:

- (a) any asset being capable of forming the subject of a security interest and not otherwise being personal to a Relevant Clearing Member;
- (b) the creation of such security interest not requiring any authorisation, consent or fulfilment of any other pre-condition or formality which has not been satisfied, obtained or done; and

- (c) any relevant contract comprised in such security being capable of being set aside as a result of any fraud, misrepresentation or any bribe or corrupt conduct.

5.2 **Enforceability of claims**

- 5.2.1 In this Opinion Letter "enforceable" means that an obligation is of a type which the Italian courts may enforce. It does not mean that those obligations will be enforced in all circumstances in accordance with the terms of the Agreements. In particular:
 - 5.2.2 the power of an Italian court to order specific performance of an obligation or other equitable remedy is discretionary and, accordingly, an Italian court might make an award of damages where specific performance of an obligation or other equitable remedy is sought;
 - 5.2.3 where any party to the Agreements is vested with a discretion or may determine a matter in its opinion, that party may be required to exercise its discretion in good faith, reasonably and for a proper purpose, and to form its opinion in good faith and on reasonable grounds;
 - 5.2.4 Claims may be or become subject to claw back or to defence of set-off or counterclaim, and their enforcement may become barred through lapse of time.
 - 5.2.5 An Italian court may stay proceedings brought in such court if concurrent proceedings are being brought elsewhere.
 - 5.2.6 A party to a contract may be able to avoid its obligations under that contract (and may have other remedies) where it has been induced to enter into that contract by a misrepresentation, or there has been any bribe or other corrupt conduct. The Italian courts will generally not enforce an obligation if there has been fraud; and
 - 5.2.7 any provision providing that any calculation, determination or certification is to be conclusive and binding may not be effective if such calculation, determination or certification is fraudulent, arbitrary or manifestly incorrect and an Italian court may regard any certification, determination or calculation as no more than prima facie evidence.

5.3 **Application of foreign law**

- 5.3.1 An Italian court may refuse to apply the law of another jurisdiction if it is deemed to be contrary to public order or if submission to foreign law is prejudicial to the application of provisions of Italian laws of mandatory application. However, it is not likely, in our view, that any terms of the Agreement would be regarded as contrary to public order or prejudicial to mandatory law in Italy.

5.3.2 We express no opinion on the binding effect of the choice of law provisions in the Agreements insofar as they relate to non-contractual obligations arising from or connected with the Agreements.

5.4 **Other qualifications**

5.4.1 Certain limitations to the exercise of termination rights under the Arrangements might derive from the so called "abuse of rights" doctrine (which is increasingly recognised by Italian courts). Under this doctrine, rights (including contractual rights) may not be exercised to achieve purposes that go beyond the "natural purpose" for which the relevant right was granted. Particularly in case of insolvency proceedings affecting a Relevant Clearing Member, termination rights under the Agreements should therefore be exercised by LCH with a view to "freeing" itself, as soon as conveniently practicable, from the contractual relationship; however, it would not be entirely appropriate, in the light of the "abuse of rights" doctrine, to seek to maximize the close-out amount (if positive) or minimize it (if negative), by selecting an early termination date - within the timeframe contractually available - with such intent. However, considering the position of LCH as central counterparty, and given that the termination of the Contracts will occur automatically in the event of the insolvency of a Relevant Clearing Member, we deem it unlikely that LCH might be regarded as having acted with a view to maximize the close-out amount (if positive) or minimize it (if negative), thus "abusing" its termination rights.

5.4.2 Pursuant to Article 55 of the Bankruptcy Law (which applies in the context of Insolvency Proceedings), interest accrual on amounts claimed vis à vis the insolvent party is suspended as from the date on which the relevant Insolvency Proceeding is initiated. It is doubtful that (in circumstances where a net amount is payable by the Clearing Member to LCH), LCH would also be entitled to claim interests on such amount.

5.4.3 If a party is controlled by or otherwise connected with a person (or is itself) resident in, incorporated in or constituted under the laws of a country which is the subject of United Nations, European Community or Italian sanctions implemented or effective in Italy under legislative decree no. 109/2007 or legislative decree no. 231/2007, or under the Treaty establishing the European Community, or is otherwise the target of any such sanctions, then the obligations of the other Party to that Party under the Arrangements may be unenforceable or void.

6. **RELIANCE AND COPIES**

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

We consent to a copy of this Opinion Letter being made publically available on the addressee's website and being shown to: (i) actual and prospective clearing members and clearing clients; (ii) relevant regulators; and/or (iii) legal counsel appointed by the addressee or any person listed in (i) above to advise on matters of the laws of other jurisdictions, in each case for information purposes only and solely on the basis that we assume no responsibility to any such parties as a result or otherwise.

**Studio Legale Associato
in Associazione con Clifford Chance**

APPENDIX 1
THE CLEARING MEMBERSHIP AGREEMENT

**APPENDIX 2
THE DEED OF CHARGE**