

LCH Limited
Aldgate House
33 Aldgate High Street
London EC3N 1EA
United Kingdom

Oslo, 1 January 2021

Attorney in charge:
Arne Tjaum

LCH Limited - Membership, Insolvency, Security, Set-off & Netting and Client Clearing - Norwegian law advice

We have been asked to provide advice in respect of the laws of Norway in response to certain specific questions raised by LCH Limited (“LCH”) in relation to membership, insolvency, security, set-off and netting and client clearing. The relevant questions are set out in full in Section 3 of this opinion letter together with the corresponding responses. Terms not otherwise defined in this advice shall have the meaning ascribed to such terms in the LCH Rulebook (as defined below).

We confirm that our advice herein is applicable to each of the LME Service, the SwapClear Service, the RepoClear Service, the EquityClear Service, the LCH Enclear OTC Service, the Turquoise Derivatives Service, the Nodal Service, the ForexClear Service, the NLX Service and the FEX Service.

1. Documents

For the purposes of giving this opinion letter, we have reviewed the following documents (the “Opinion Documents” or the “LCH Agreements”):

- (a) The LCH Rulebook consisting of:
 - (i) The General Regulations dated November 2020,
 - (ii) the Procedures Section 1 dated March 2020,
 - (iii) the Procedures Section 2B dated December 2020,
 - (iv) the Procedures Section 2C dated December 2020,
 - (v) the Procedures Section 2D dated September 2020,
 - (vi) the Procedures Section 2I dated December 2020,

Ref.: #8479876/7

- (vii) the Procedures Section 2J dated May 2020,
 - (viii) the Procedures Section 3 dated September 2020,
 - (ix) the Procedures Section 4 dated April 2020,
 - (x) the Procedures Section 5 dated November 2020,
 - (xi) the Procedures Section 6 dated November 2020,
 - (xii) the Procedures Section 7 dated November 2020,
 - (xiii) the Procedures Section 8 dated May 2020,
 - (xiv) the Default Rules dated November 2020,
 - (xv) the Settlement Finality Regulations dated December 2019, and
 - (xvi) the Product Specific Contract Terms and Eligibility Criteria Manual dated December 2020.
- (b) A Clearing Membership Agreement (as defined in the LCH Rulebook) which is substantially in the form appended as Schedule 3 of this opinion letter (the “**Clearing Membership Agreement**”);
 - (c) 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 Schedule 4 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
 - (d) A security deed to be made by way of deed poll by a Clearing Member in its capacity as chargor in favour of each Client (the “**Security Deed**”).

For the purposes of our advice, we have made the assumptions set out in Schedule 1 to this opinion letter. Our advice is subject to the reservations set out in Schedule 2 to this opinion letter.

2. Definitions

In this opinion letter:

- (a) “**Administration Board**” means a board appointed by the FSAN in connection with Public Administration or Resolution.
- (b) “**Bankruptcy Act**” means the Norwegian Act on Debt Settlement Proceedings and Bankruptcy Proceedings of 8 June 1984 (as amended).

- (c) “**Bankruptcy Proceedings**” means the proceedings referred to in paragraph 3.2 below.
- (d) “**Brexit**” means the United Kingdom’s withdrawal from the EU including the expiry of the transition period agreed between the United Kingdom and the EU in relation thereto.
- (e) “**BRRD**” means Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms.
- (f) “**BRRD Entities**” means Relevant Clearing Members which are (i) banks and other credit institutions, (ii) financial holding companies (Norwegian: *holdingforetak i finanskonsern*), (iii) financing companies (Norwegian: *finansieringsforetak*) who are part of a financial group (Norwegian: *finanskonsern*) or (iv) investment firms which deal in financial instruments for its own account and/or underwrite issues of financial instruments on a firm commitment basis.
- (g) “**Civil Procedure Act**” means the Norwegian Civil Procedure Act of 17 June 2005 (as amended).
- (h) “**Contracts Act**” means the Norwegian Contracts Act of 31 May 1918 (as amended).
- (i) “**CR Act**” means the Norwegian Creditors Recovery Act of 8 June 1984 no 59 (as amended).
- (j) “**Date of Filing**” means:
 - (i) in relation to Bankruptcy Proceedings, the date when a successful petition for the opening of Bankruptcy Proceedings was received by the relevant court;
 - (ii) in relation Debt Settlement Proceedings or Debt Restructuring Proceedings, the date when the petition for the opening of Debt Settlement Proceedings or Debt Restructuring Proceedings was received by the relevant court; and
 - (iii) in relation to Public Administration, the date when the Norwegian Ministry of Finance resolves that the BRRD Entity shall be Resolved or placed under Public Administration for dissolution.
- (k) “**Debt Settlement Proceedings**” and “**Debt Restructuring Proceedings**” means the proceedings referred to in paragraph 3.2 below.
- (l) “**Derivatives**” means the Financial Instruments referred to in Section 2-4 (7) of the ST Act.
- (m) “**EMIR**” means Regulation (EU) No 648/2012.
- (n) “**ESMA**” means the European Securities and Markets Authority.
- (o) “**FC Act**” means the Norwegian Financial Collateral Act of 26 March 2004 no. 17.

- (p) “**Financial Collateral**” means cash deposits, Financial Instruments and claims for the repayment of money arising out of a credit institution granting credit to a debtor not being a consumer, cf. Section 2(1)(c) of the FC Act.
- (q) “**Financial Instruments**” means the instruments defined as financial instruments (Norwegian: *finansielle instrumenter*) pursuant to Section 2-2 of the ST Act.
- (r) “**Financial Undertakings Act**” means the Norwegian Act on Financial Undertakings and Financial Groups of 10 April 2015 no. 17 (as amended).
- (s) “**FSAN**” means the Financial Supervisory Authority of Norway (Norwegian: *Finanstilsynet*)
- (t) “**Insolvency Proceedings**” means Bankruptcy Proceedings and Public Administration.
- (u) “**Parties**” means the parties to any of the Opinion Documents, and “**Party**” means either of them.
- (v) “**Perfected Contract**” means a Contract which has been entered into the relevant Securities Settlement System prior to the opening of Insolvency Proceedings or Reorganisation Measures of a Relevant Clearing Member.
- (w) “**Pledge Act**” means the Norwegian Pledge Act of 8 February 1980 (as amended).
- (x) “**PS Act**” means the Norwegian Act on Payment Systems etc. of 17 December 1999 (as amended).
- (y) “**Public Administration**” means the proceedings referred to in paragraph 3.2 below.
- (z) “**Regulation on Equivalence Decisions under EMIR**” means the Norwegian Regulation on Equivalence Decisions under EMIR of 30 June 2017 (as amended).
- (aa) “**Relevant Clearing Member**” means a clearing member of LCH incorporated in Norway.
- (bb) “**Relevant Jurisdiction**” means Norway.
- (cc) “**Reorganisation Measures**” means Debt Settlement Proceedings, Debt Restructuring Proceedings and Resolution.
- (dd) “**Resolution**” means the proceedings referred to in paragraph 3.2 below.
- (ee) “**Securities Settlement System**” means a system based on common rules for netting, settlement or transfers of Financial Instruments.
- (ff) “**SFD**” means Directive 98/26/EC.
- (gg) “**ST Act**” means the Norwegian Securities Trading Act of 29 June 2007 (as amended).
- (hh) “**Transfer Orders**” has the meaning given to the term “transfer order” in article 2(i) of the SFD (as amended).

- (ii) Debt Settlement Proceedings or Debt Restructuring Proceedings are “**opened**”, “**commenced**” or “**initiated**” (and synonymous or derivative expressions) at the time at which the decision to open Debt Settlement Proceedings or Debt Restructuring Proceedings was received by the district court.
- (jj) Bankruptcy Proceedings are “**opened**”, “**commenced**” or “**initiated**” (and synonymous or derivative expressions) at the time at which the decision to open Bankruptcy Proceedings was passed by the competent court.
- (kk) Resolution is “**commenced**” or “**initiated**” (and synonymous or derivative expressions) at the time at which the decision to Resolve the BRRD Entity has been passed by the Norwegian Ministry of Finance.
- (ll) Public Administration is “**opened**”, “**commenced**” or “**initiated**” (and synonymous or derivative expressions) at the time at which the decision to open Public Administration has been passed by the Norwegian Ministry of Finance.
- (mm) Financial Collateral is deemed to have been “**granted**” or “**provided**” (and synonymous or derivative expressions) when all perfection requirements applicable to that Financial Collateral have been duly fulfilled.

3. Membership

General

3.1 *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 *Would LCH be deemed to be domiciled, resident or carrying on business in the Relevant Jurisdiction by virtue of providing clearing services to a Relevant Clearing Member? If so, would LCH be required to obtain any additional licences or additional registrations before providing clearing services to a Relevant Clearing Member or are there any special local arrangements for the recognition of overseas clearing houses in these circumstances?*

BAHR response: A Relevant Clearing Member is not as such subject to any local licensing requirements in Norway. However, pursuant to Section 17-5 of the ST Act, participation in a CCP on behalf of clients (i.e. provision of client clearing services) may only be conducted by an investment firm, credit institution or any other entity carrying out the activities mentioned in Section 2-1 of the ST Act (being investment services and activities, or ancillary services).

It is not clear whether this provision applies only to participation in a Norwegian CCP or if it also extends to a Relevant Clearing Member’s participation in a non-Norwegian CCP such as LCH.

The wording in Section 17-5 of the ST Act is general, which suggests that the provision applies to participation in any CCP irrespective of whether the CCP is established in Norway or abroad. Hence, when looking solely at the wording used, it captures participation in the LCH “system” by a Relevant Clearing Member that clears transactions on behalf of its clients.

According to the preparatory works of the ST Act, the main objective of Section 17-5 is not to regulate the type of entities that may participate in a CCP as clearing member. Rather, the objective is to protect the interests of clients of clearing members by stipulating that only certain entity types being subject to regulatory supervision are allowed to clear transactions on behalf of clients. In our opinion this objective is equally relevant in respect of client clearing through a foreign CCP such as LCH, which suggests that the rule applies also for participation in foreign CCPs.

Pursuant to EMIR, EU based CCPs must have an approved Securities Settlement System. The PS Act does not lay any restrictions on the access to participate in a Securities Settlement System, meaning that any person in principle would be free to participate in a Norwegian CCP on behalf of its clients had it not been for the rule in Section 17-5 of the ST Act. According to the preparatory works of the ST Act, several EU Member States have taken a different approach and implemented rules which entail that only credit institutions and investment firms may participate in Securities Settlement Systems established in their jurisdiction. Consequently, only credit institutions and investment firms are given access to participate directly in a CCP in such Member States. The lack of similar restrictions in the PS Act was a weighty argument in favour of retaining Section 17-5 of the ST Act when EMIR was implemented in Norway in 2017.

In light of the above and the fact that there appears to be discrepancies between different jurisdictions with respect to how participation in CCPs is regulated, it could be argued that an entity’s access to participate in a CCP should be governed by the laws of the country where the CCP is established, which in the case of LCH would be England. Further, it could be argued that conflict of laws may arise by applying Norwegian law to decide whether a Relevant Clearing Member shall be permitted to participate in LCH on behalf of its clients. However, as stated above, the core purpose of the rule in Section 17-5 in the ST Act is to protect the clients of participants and not limit the circle of entities that are eligible for participation in the system as such. On this basis, there is in our opinion no contradiction between applying the rule in Section 17-5 of the ST Act on a Relevant Clearing Member’s participation in LCH and possible English rules governing participation in a CCP.

Except for the rule in Section 17-5 of the ST Act relating to the provision of client clearing services, there are no relevant statutory limitations on the capacity or ability of a Relevant Clearing Member to enter into the LCH Agreements, provided that entering into and performing its obligations under the LCH Agreements falls within the Relevant Clearing Member’s corporate objective, bye-laws and license requirements. In order to verify this, LCH should obtain the necessary confirmations of capacity (including legal opinions, as applicable) from its Relevant Clearing Member before providing clearing services.

LCH will not, as a consequence of the execution of the LCH Agreements with a Relevant Clearing Member or performance or enforcement of the LCH Agreements and contracts be deemed to be domiciled or resident in Norway.

It follows from Article 14 (2) of EMIR – as included in the EEA Agreement and subsequently transposed into Norwegian law through Section 17-1 of the ST Act – that an authorisation granted in accordance with Article 17 of EMIR shall be effective for the entire EEA. Based on our understanding that LCH is duly authorised as a CCP under EMIR, LCH may offer clearing services to Relevant Clearing Members without triggering any additional licencing or authorisation requirements in Norway.

Due to expiry of the transition period set out in the Brexit withdrawal agreement¹ between the UK and the EU, LCH will after 31 December 2020 no longer benefit from mutual recognition under Article 14 (2) and will therefore need to rely on recognition as a third-country CCP under Article 25 of EMIR in order to offer clearing services in the EEA.

The Norwegian Ministry of Finance has previously confirmed that, to the extent that UK central counterparties will be able to continue to provide clearing services in the European Union following a “no-deal Brexit”, Norwegian authorities will take the necessary steps to procure that UK central counterparties also will be able to continue to provide such services in Norway.² The European Commission implementing Decision (EU) 2018/2031 of 19 December 2018 (as amended by the European Commission Implementing Decision (EU) 2019/544 of 3 April 2019, the European Commission Implementing Decision (EU) 2019/2211 of 19 December 2019 and the Commission Implementing Decision (EU) 2020/1308 of 21 September 2020) has been transposed into Norwegian law in Section 1(10) of the Regulation on Equivalence Decisions under EMIR. Accordingly, LCH is not required to obtain any additional licences or additional registrations in Norway in order to provide clearing services to Relevant Clearing Members from 1 January 2021 to 30 June 2022.

Insolvency, Security, Set-off and Netting

3.2 *Please opine on insolvency proceedings (the “**Insolvency Proceedings**”) and pre-insolvency reorganisation, restructuring and/or resolution measures (the “**Reorganisation Measures**”) in respect of Relevant Clearing Members under the laws of the Relevant Jurisdiction and the effect of these on the security interests, and set-off and netting arrangements, provided for under the terms of the LCH Agreements. If your responses to the Evolution Phase 1 questionnaire confirmed that local law in your jurisdiction afforded protections to LCH as contemplated in Recital 7 of the Settlement Finality Directive (or if there is uncertainty on which protections may apply, counsel should advise on the points of certainty and respond to the remainder of this question accordingly), will the analysis in the existing Opinion which is based on your jurisdiction’s implementation of the Settlement Finality Directive be the same in relation to security interests, and set-off and netting arrangements? Would*

¹ Officially titled ‘Agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community’, signed on 24 January 2020.

² The confirmation was given through a public statement on the Norwegian Government’s website on 20 December 2018, see <https://www.regjeringen.no/en/aktuelt/brexit-beredskap-pa-finansmarkedsomradet--oppfolging-av-kommisjonsvedtak/id2623639/>.

the protections afforded to a third country system be equivalent to those LCH currently benefits from under the EU Settlement Finality Directive?

BAHR response: General Norwegian insolvency law recognises two main types of proceedings/measures: Debt Settlement Proceedings (Norwegian: *gjeldsforhandling*) and Bankruptcy Proceedings (Norwegian: *konkurs*). The main legislation governing such proceedings is found in the Bankruptcy Act and the CR Act. There is also a temporary legislation in place for debt restructuring proceedings, see below.

A fundamental difference between Debt Settlement Proceedings and Bankruptcy Proceedings lies in the ultimate goal of the respective proceedings: while Debt Settlement Proceedings aim at reducing and/or restructuring the debtor's liabilities so that it can continue its business going forward, Bankruptcy Proceedings are a pure liquidation process where the goal is to maximise the value of the debtor's estate, liquidate it and distribute the proceeds thereof to the debtor's creditors. Both natural persons and legal entities can be subject to Debt Settlement Proceedings and Bankruptcy Proceedings. Legal entities in Bankruptcy Proceedings will be liquidated and cease to exist when the Bankruptcy Proceedings end.

Although large parts of Norwegian insolvency legislation apply to both Debt Settlement Proceedings and Bankruptcy Proceedings, there are many special rules which only apply to either type of proceeding. As a starting point, the requirements for invoking either type of proceeding are different: Debt Settlement Proceedings can be requested when the debtor is unable to pay its bills as they fall due (illiquidity), whereas in Bankruptcy Proceedings there is an additional requirement that the debtor's liabilities exceed the value of its assets (insufficiency). In Debt Settlement Proceedings, the debtor retains control of its assets and can continue its business subject to a number of restrictions and the scrutiny of a specially appointed restructuring board (Norwegian: *gjeldsnemnd*). Conversely, in Bankruptcy Proceedings all of the debtor's assets are seized by the bankruptcy estate (Norwegian: *konkursbo*), which is a separate legal entity established by the court to oversee the liquidation and distribution of the debtor's assets to the creditors. This characteristic difference between Debt Settlement Proceedings and Bankruptcy Proceedings has an impact on the rules relating to the treatment of the debtor's contracts.

Pursuant to Section 7-3 of the CR Act, a bankruptcy estate is (subject to certain exceptions not discussed herein) entitled to assume (or "step into") a bankrupt debtor's mutually obligating (Norwegian: *gjensidig bebyrdende*) contracts, i.e. contracts where the parties have rights and obligations towards each other. The bankruptcy administrator has a discretionary right to "cherry pick", and cause the estate to only step into contracts deemed beneficial for the purposes of the Bankruptcy Proceedings. However, when the estate has assumed a contract, it becomes bound by it and must fulfil the debtor's contractual obligations towards the other contract party(-ies) in accordance with the contract's terms (subject to a statutory early termination right which is not discussed herein).

Conversely, in Debt Settlement Proceedings, the debtor's contracts continue uninterrupted without any step-in or "cherry picking" rights, cf. Section 7-3a of the CR Act. This is a natural consequence of the fact that a debtor in Debt Settlement Proceedings, unlike in Bankruptcy Proceedings, retains control over its assets. However, the commencement of Debt

Settlement Proceedings triggers a statutory early termination right (which is not discussed herein).

The financial distress caused by the global Covid-19 outbreak in the spring of 2020 has prompted the Norwegian government to enact a new temporary debt restructuring act providing for new and temporary rules on debt restructuring (“**Debt Restructuring Proceedings**”) which replaces the rules for Debt Settlement Proceedings between 11 May 2020 and 1 January 2022. The temporary rules on Debt Restructuring Proceedings differ from the ordinary Debt Settlement Proceedings in a number of ways, as further described below. Such Debt Restructuring Proceedings are not applicable to BRRD Entities.

With effect as of 1 January 2019, BRRD has been implemented in Norway through amendments to the Financial Undertakings Act. This has implications for Relevant Clearing Members who are subject to BRRD, i.e. BRRD Entities as defined above.

In the following we will discuss the applicable Insolvency Proceedings and Reorganisation Measures regimes for Relevant Clearing Members who are BRRD Entities, and for those who are not.

Relevant Clearing Members who are BRRD Entities

The only bankruptcy, composition, rehabilitation or other insolvency or reorganisation procedures to which a BRRD Entity could be subject under the laws of Norway, is Resolution and Public Administration as further set out in the Financial Undertakings Act.

Resolution

Resolution is a reorganisation measure which entails one or several actions taken by the Resolution Authority in accordance with BRRD to facilitate the recovery of a failed BRRD Entity.

As per the BRRD and the Financial Undertakings Act, a BRRD Entity may be subject to Resolution if the Ministry of Finance considers that (i) the BRRD Entity is failing or likely to fail, (ii) there is no reasonable prospect that any alternative private sector measures, early intervention measures or conversion or write down of capital would prevent the failure of the relevant BRRD Entity within a reasonable timeframe and (iii) Resolution is in the public interest.

The Resolution tools available to the Resolution Authority are: (i) sale of business, (ii) bridge institution, (iii) asset separation and (iv) bail-in. Each tool may be applied individually or in combination, but the asset separation tool may only be applied together with another tool. The specific conditions for application and implications of the different tools are further set out in the BRRD and Chapter 20 of the Financial Undertakings Act. Further, in the event of a serious disturbance to the financial system, the Ministry of Finance may on certain conditions provide extraordinary public financial support to a BRRD Entity either through equity contributions or via temporary public ownership tools. Any such extraordinary financial support must be provided in accordance with the EU state aid framework.

The BRRD, as transposed into Norwegian law through Chapter 20 of the Financial Undertakings Act, gives the Resolution Authority wide powers to amend or terminate a failing BRRD Entity's existing contracts, but also provides protection from Resolution actions for certain types of creditors and counterparties. Crucially, the operation of clearing, payment and settlement systems is protected from the Resolution Authority's decision to partially transfer a BRRD Entity's assets or business or exercise its right to amend or terminate contracts. The rules also contain similar protection for financial collateral, set-off and netting arrangements comprised by the FC Act and the PS Act. These protections should extend to the security interests, set-off and netting arrangements provided for under the terms of the LCH Agreements. It should be noted that some protections afforded under Chapter 20 of the Financial Undertakings Act only are available to participants in recognised 'systems' under the PS Act. Following Brexit, such protections will extend to a Relevant Clearing Member's participation in LCH's Securities Settlement System provided that the Relevant Clearing Member has notified the FSAN of such participation and the FSAN has published the notice. Please refer to paragraph 5.1 below for further details.

Public Administration

If the conditions for Resolution of a BRRD Entity are otherwise met but the Ministry of Finance does not consider that Resolution would be in the public interest, the BRRD Entity will be placed under Public Administration and subsequently wound up.

The law states that Public Administration shall be completed in accordance with the FC Act, the CR Act and the bankruptcy rules set out in Part 2 of the Bankruptcy Act. A winding-up estate (Norwegian: *avviklingsbo*) shall be registered in the Norwegian Register of Legal Entities (Norwegian: *Enhetsregisteret*), and the winding-up proceedings shall be completed much in the same way as in the case of ordinary Bankruptcy Proceedings.

However, a BRRD Entity will during Public Administration have its governing bodies replaced by an Administration Board and cannot, among other things, accept or repay deposits, grant new credit or expand current credits without the FSAN's approval. This is similar to the legal effects of Debt Settlement Proceedings as described in Section 14 of the Bankruptcy Act, and distinctly different from the consequences of the commencement of Bankruptcy Proceedings as described in Section 100 of the same act. In the bankruptcy setting, it does not make sense to talk about what the debtor can or cannot do with its assets, because the debtor has no right to use or dispose of most of its assets once Bankruptcy Proceedings have commenced and the debtor's assets have been seized by the bankruptcy estate.

There is no precedent available to shed light on how the courts consider Public Administration in light of the traditional insolvency legislation. The only known case of public administration of a bank in Norway in recent years is the public administration of the Norwegian branch of Icelandic bank Kaupthing Banki Hf in 2008. Based on conversations with the former chairman of Kaupthing's administration board, our understanding is that the administration board found it difficult to draw an exact line between applicable and non-applicable rules in the CR Act. However, in relation to Kaupthing's contracts, we understand that the administration board did not consider itself legally entitled to "cherry-pick"

contracts pursuant to Section 7-3 of the CR Act (which is a provision only applicable in Bankruptcy Proceedings).

Whether or not this has changed with the introduction of the new Chapter 20 in the Financial Undertakings Act from 1 January 2019 is not clear, as neither the statute nor the preparatory works provide clear guidance on the subject. It is therefore a somewhat open question if the Administration Board of a BRRD Entity under Public Administration has a right to “cherry pick” contracts of the entity under administration.

Relevant Clearing Members who are not BRRD Entities

A Relevant Clearing Member which is not a BRRD Entity can, pursuant to Norwegian law, only become subject to ordinary Debt Settlement Proceedings or Bankruptcy Proceedings. As mentioned above, temporary rules on Debt Restructuring Proceedings have replaced the ordinary rules on Debt Settlement Proceedings with effect from 11 May 2020 to 1 January 2022. The key differences between Debt Settlement Proceedings and Debt Restructuring Proceedings are set out below.

Debt Settlement Proceedings

Debt Settlement Proceedings can be requested by debtors who are unable to meet their obligations as they fall due, but who are not necessarily insolvent. Debt Settlement Proceedings consist of negotiations between the debtor and its creditors over either a voluntary settlement or a compulsory composition.

During Debt Settlement Proceedings, the debtor will continue to operate under its management subject to certain restrictions and the supervision of a creditor committee. The debtor retains its assets and remains authorised to contract with third parties, but must obtain the consent of the restructuring board in order to sell assets, grant security, acquire property or lend certain important assets. The debtor’s mutually obligating contracts which were concluded prior to the opening of the Debt Settlement Proceedings continue to remain in force.

After a petition for Debt Settlement Proceedings has been submitted, Section 16 of the Bankruptcy Act states that a petition for bankruptcy submitted by creditors of claims arising prior to the opening of Debt Settlement Proceedings cannot be granted until after the petition for Debt Settlement Proceedings has been revoked, denied or cancelled, or after the Debt Settlement Proceedings have been completed. There are however exceptions to this rule, e.g. that the petitions for bankruptcy may be granted three months after the opening of Debt Settlement Proceedings.

The Debt Settlement Proceedings may result in a voluntary settlement (consisting of a payment extension, pro rata reduction of debt, liquidation of all or parts of the debtor’s assets or a combination of these measures) or a compulsory composition (consisting of a payment extension, pro rata reduction of debt, liquidation of all or parts of the debtor’s assets or a combination of these measures). In voluntary settlement proceedings, the adoption of a voluntary settlement requires the consent of all creditors comprised by the

proposed settlement. The adoption of a compulsory composition requires the consent of 60% of the creditors if the proposed composition will cover at least 50% of the debtor's debt or 75% of the creditors if the proposed composition will cover less than 50% of the debt. A compulsory composition may however not be adopted unless it will cover at least 25% of the debtor's debt.

Debt Restructuring Proceedings

The temporary rules on Debt Restructuring Proceedings differ from the rules on ordinary Debt Settlement Proceedings in a number of ways:

- The threshold for initiating Debt Restructuring Proceedings is lower than for Debt Settlement Proceedings: Debt Restructuring is available to debtors that are facing serious economic difficulties in the near-term without necessarily being unable to pay their debts as they fall due.
- Any of the debtor's creditors may request Debt Restructuring Proceedings if the debtor is unable to meet its obligations as they fall due. By contrast, as noted above, only the debtor can request the initiation of ordinary Debt Settlement Proceedings.
- The threshold for approving a debt restructuring proposal is lower than the applicable approval thresholds for adopting a voluntary settlement or compulsory composition as part of ordinary Debt Settlement Proceedings.
- A termination of contract because of the debtor's non-payment which is declared within the last four weeks before an application for Debt Restructuring Proceedings is filed will not be enforceable during the Debt Restructuring Proceedings, unless the other party had already effectuated the termination by the time the application for the Debt Restructuring Proceedings was filed.
- After the commencement of Debt Restructuring Proceedings, the other party may not invoke the debtor's actions prior to such proceedings as grounds for termination during the proceedings.
- The stay period during which security interests may generally not be enforced, will remain in place for the duration of the Debt Restructuring Proceedings without any particular time limit. However, it should be noted in this regard that the debt restructuring period shall normally not exceed six months, and that the stay does not apply to security interests over monetary claims or any financial collateral arrangement in accordance with the FC Act, as further discussed herein.

References to Debt Settlement Proceedings in this opinion letter should be read with the above-mentioned distinctions in long as the temporary act on Debt Restructuring Proceedings is in force.

Bankruptcy Proceedings

Bankruptcy Proceedings may be opened where a debtor, following a petition to the courts from either the debtor or its creditors, is found to be insolvent. Bankruptcy Proceedings may also in certain cases be instigated following failed Debt Settlement Proceedings. The purpose of Bankruptcy Proceedings is to liquidate the debtor’s assets for the benefit of its creditors and to distribute the proceeds in accordance with the distribution rules set out in Chapter 9 of the CR Act.

The instigation of Bankruptcy Proceedings results in the formation of the debtor’s insolvency estate. The insolvency estate is a legal person separate from the debtor which is, subject to certain exceptions, entitled to seize the assets of the debtor and to step into and “cherry pick” the mutually obligating contracts of the debtor pursuant to Section 2-2 and 7-3 of the CR Act.

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

BAHR response: Please see our response to 3.2 above for a description of the different types of Insolvency Proceedings and Reorganisation Measures available under Norwegian law.

In our opinion, all of the different types of Insolvency Proceedings and Reorganisation Measures available under Norwegian law would 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. No events or procedures other than those envisaged in Rule 3 or Rule 5 of the Default Rules appear to be relevant.

- 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?*

BAHR response: In case of Resolution of a BRRD Entity, it follows directly from BRRD Art. 76-80 (as implemented in Norway from 1 January 2019) that the Deed of Charge will be protected against any resolution actions taken by the Resolution Authority. Some of these articles relate to the protections offered by the Financial Collateral Directive (implemented in Norway through the FC Act), which will apply irrespective of LCH being established in an EU member state or not. Other protections only extend to CCPs which are “systems” within the meaning of the SFD and the PS Act. In order for these protections to extend to a Relevant Clearing Member’s participation in LCH’s Securities Settlement System after Brexit, the conditions discussed in paragraph 5.1 below must be met.

In order for the Deed of Charge to be effective in the context of Public Administration, Debt Settlement Proceedings and Bankruptcy Proceedings in respect of a Relevant Clearing Member, two general conditions would in our view have to be fulfilled: (i) LCH would have to be able to net the obligations of the Relevant Clearing Member, turning these obligations into a net claim; and (ii) LCH would have to be able to enforce this resulting net claim against the Relevant Clearing Member pursuant to the Deed of Charge.

Section 4-2 (1) of the PS Act states that agreements regarding netting and settlement may be enforced in accordance with their terms even where Insolvency Proceedings or Reorganisation Measures have been initiated against a Relevant Clearing Member, insofar as they relate to Perfected Contracts which have been entered into the Securities Settlement System prior to the opening of Insolvency Proceedings, cf. Section 4-2 (1) of the PS Act.

We are of the opinion that items (b), (h)(v) and (k) of Rule 6 of the Default Rules of the LCH Rulebook constitute an agreement regarding netting (Norwegian: *avtale om avregning*) for the purposes of Section 4-2 of the PS Act, cf. the discussion in paragraph 3.2.3(a) below. This means that even if Insolvency Proceedings have been initiated against a Relevant Clearing Member, LCH would be entitled to net all sums under the Perfected Contracts in accordance with the Default Rules. Following Brexit, Section 4-2 of the PS Act will apply to a Relevant Clearing Member's participation in LCH's Securities Settlement System, provided that the conditions set out at paragraph 5.1 below are met.

Following the netting of the Perfected Contracts, the Parties would be left with a net claim and a net obligation. This net claim or obligation would then constitute a "financial obligation" (Norwegian: *finansiell forpliktelse*) for the purposes of the FC Act. Section 7 of the FC Act permits enforcing Financial Collateral for financial obligations on the terms and conditions set out in the agreement between the parties, also after Insolvency Proceedings have been initiated against a Relevant Clearing Member. Given that the net claim or obligation following the above-described netting is a financial obligation and that the Collateral granted under the Deed of Charge is Financial Collateral, it is our opinion that the Deed of Charge would be effective in the context of Insolvency Proceedings or Reorganisation Measures in respect of a Relevant Clearing Member.

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

As discussed in more detail in paragraph 4.4 below, we believe that in the event of Insolvency Proceedings or Reorganisation Measures being commenced against a Relevant Clearing Member, the rights and obligations of that Relevant Clearing Member in relation to the

Securities Settlement System operated by LCH would be determined by the application of English law, being the law governing that Securities Settlement System.

If, however, Norwegian courts were to take the view that Norwegian law applies to such questions, our view is that (without the consent of the FSAN), LCH would be able to take the actions described in items (b), (h)(v) and (k) of Rule 6 of the Default Rules against a Relevant Clearing Member once Insolvency Proceedings or Reorganisation Measures have been commenced.

As regards whether or not LCH will have the right to take the actions provided for in the Default Rules in the event that a Relevant Clearing Member is subject to Insolvency Proceedings or Reorganisation Measures and has been designated as a “Defaulter”, a distinction must be made between actions which result in the Defaulter being given new obligations (see (a) below) and the actions which result in the termination of Contracts (see (b) below).

Automatic early termination is discussed at (c) below.

(a) Actions resulting in new disposals/obligations post opening of Insolvency Proceedings or Reorganisation Measures

Bankruptcy Proceedings

Pursuant to Section 100 of the Bankruptcy Act, the debtor is not entitled to make any disposals on behalf of the insolvency estate after the opening of Bankruptcy Proceedings, hereunder incurring new obligations. Further, it follows from Section 23 of the Contracts Act that actions taken by an agent in the name of his principal are not binding on the principal’s insolvency estate to any further extent than if the action was taken by the principal himself. Therefore, actions taken under the Default Rules which constitute disposals either over the assets of the insolvency estate (Norwegian: *forføye over boets eiendeler*) or otherwise on behalf of the insolvency estate after the opening of Bankruptcy Proceedings (“**New Disposals**”) are not binding upon the insolvency estate. In our opinion, the following actions in the Default Rules would, if taken following the opening of Insolvency Proceedings, constitute New Disposals:

- (i) registering an original contract, OTC Transaction or FCM Transaction in the name of the Defaulter under Rule 6(a);
- (ii) to effect a closing-out in respect of an open contract of the Defaulter by entering into a closing-out contract under Rule 6(b);
- (iii) to invoice a contract back under Rule 6(d);
- (iv) to exercise an option of the Defaulter on its behalf under Rule 6(f);
- (v) to transfer an open contract from the account of another Clearing Member to the account of the Defaulter under Rule 6(g);

- (vi) to tender (or submit a Delivery Notice) or to receive a tender (or a Delivery Notice) in the Defaulter's name under Rule 6(i);
- (vii) to perform on an open contract subject to tender (or an FCM Exchange Contract Subject to Delivery Notice) or a delivery contract (or Physically-Settled FCM Exchange Contract) by either delivery of or by accepting delivery of the commodity which is the subject of such contract to or from, as the case may be, the Defaulter, its agent or a third party in any manner permitted by the terms of the Contract and the Exchange Rules (if any) under Rule 6(j);
- (viii) to make or to procure the making of one or more contracts, including (without limitation) original contracts, and contracts on an exchange that does not qualify as an Exchange, for the purpose of hedging market risk to which the Defaulter is exposed, and to register the same in the Defaulter's name under the Regulations, the FCM Regulations or the SC Regulations (as the case may be) under Rule 6(l);
- (ix) to make or to procure the making of one or more contracts, whether or not in the terms of exchange contracts (or FCM Exchange Transactions), for the sale, purchase or other disposition of a commodity, and to register the same in the Defaulter's name under the Regulations under Rule 6(n); and/or
- (x) to take such action as the Clearing House may deem necessary for its protection in the name and at the expense of the Defaulter with regard to any open contract standing in its name under Rule 6(q).

The above-mentioned actions would therefore not be binding upon the insolvency estate if executed following the opening of Bankruptcy Proceedings. There are no applicable exemptions.

Public Administration

As regards Public Administration, Section 20-30(1) of the Financial Undertakings Act provides that the effect of Public Administration is *inter alia* that the prior consent of the FSAN is required for a BRRD Entity to accept deposits or otherwise incur new debt, assume new engagements or increase existing engagements, or make payments to depositors or other creditors. These restrictions are not commented on in the preparatory works of the act, and there are no court precedents available. In particular, it is unclear what is meant by a bank assuming new engagements (Norwegian: *påta seg nye engasjementer*). A literal interpretation of this expression suggests that it only concerns the lending out of money or assumption of a commitment to lend out money. There is however a risk that the expression could be given a wider interpretation, and therefore cover the assumption of new obligations. A factor supporting this view is Section 20-30(2) of the Financial Undertakings Act, which states that new obligations incurred after the entity was placed under Public Administration is considered as preferred debt, which could suggest that new obligations may only be incurred by the administration board and, conversely, not by the counterparties of the BRRD Entity exercising contractual rights established prior to the opening of Public Administration. If the expression "assuming new engagements" is given the latter

interpretation, this would jeopardise the effectiveness of the actions mentioned in items (i) - (x) above.

There are no applicable exemptions.

Debt Settlement Proceedings

As regards the effects of Debt Settlement Proceedings, the debtor is as a rule entitled to dispose of its assets. However, Subsection 2 of Section 14 of the Bankruptcy Act states that the consent of the restructuring board is required for the debtor to incur or refinance debts, grant as security, sell or lease its immovable property, offices or any other assets of material importance. Firstly, it should be noted that the expression “to incur ... debts” in light of the preparatory works of the Bankruptcy Act covers only the incurrence of obligations to pay monies in the future and not other obligations which are to be performed in the future. Therefore new obligations require the consent of the restructuring board if the obligation is performed by the future payment of monies. This would in our opinion cover the actions referred to in items (i), (ii) (iii), (v), (viii), (ix) and (x) above where the debtor is to perform by cash payment. Secondly, the same actions, as well as exercising a put option pursuant to the action referred to item (iv) above, would require the consent of the restructuring board where the debtor’s performance concerns the transfer of ownership of an asset of material importance to the business of the debtor. If any actions under the Default Rules are taken in breach of Subsection 2 of Section 14 of the Bankruptcy Act, the actions will be binding if LCH in good faith was not aware that the consent of the restructuring board was required due to the opening of Debt Settlement Proceedings.

Resolution

In the event of Resolution of a BRRD Entity, items c) and d) of Section 20-18(1) of the Financial Undertakings Act provides that the FSAN can decide to impose restrictions on the entity’s ability to accept deposits or otherwise incur new debt, assume new engagements or increase existing engagements, or make payments to depositors or other creditors. If such restrictions are imposed, the effect will be as described under Public Administration above.

(b) Actions resulting in the termination of LCH’s obligations

Under Norwegian insolvency law, the insolvency estate of the debtor will, as a general rule, following the opening of Bankruptcy Proceedings be entitled to step into the mutually obligating agreements which the debtor has concluded, cf. Section 7-3 of the CR Act. Where the debtor is subject to Debt Settlement Proceedings, the agreements of the debtor continue in full force and effect as prior to the opening of such proceedings, cf. Section 7-3a of the CR Act. Section 7-3(2)(2) of the CR Act states that contractual provisions which give the counterparty a more extensive right to terminate the agreement following the insolvency of the debtor are not binding on the insolvency estate. This provision applies mutatis mutandis following the opening of Debt Settlement Proceedings, cf. Section 7-3a(1)(3) of the CR Act.

In both Insolvency Proceedings and Debt Settlement Proceedings, a consequence of the statutory provisions referred to above is that the counterparties of the debtor may not

terminate Contracts on grounds of the opening of the applicable Insolvency Proceedings or Debt Settlement Proceedings in the absence of an applicable exemption. In our opinion, the following actions would constitute a termination for the purposes of Sections 7-3 and 7-3a of the CR Act:

- (i) to effect the transfer or termination, close-out and cash-settlement of an open contract of the Defaulter under Rule 6(b);
- (ii) to settle an open contract under Rule 6(c);
- (iii) to transfer an open contract of the Defaulter to the account of another Clearing Member or to terminate and re-establish it with another Clearing Member under Rule 6(g)(i) and (ii) respectively;
- (iv) to close-out and terminate an open contract under Rule 6(g)(iii);
- (v) to transfer or terminate and close-out contracts under Rule 6(h);
- (vi) to declare the Defaulter's right and obligations in respect of an open contract subject to tender (or an FCM Exchange Contract Subject to Delivery Notice) discharged under Rule 6(k); and
- (vii) to transfer an open contract of the Defaulter under Rule 6(o).

Whether or not LCH will have the right to take such actions in the event that a Relevant Clearing Member is subject to Insolvency Proceedings therefore depends on whether applicable exemptions are available. Possible exemptions are discussed at (i) - (iii) below.

- (i) The right to terminate due to the nature of the contract

Section 7-3(2)(1) of the CR Act states that the step-in right of the insolvency estate does not affect the counterparty's right to invoke the insolvency as a termination event due to the nature of the agreement (Norwegian: *avtalens art*). The same applies mutatis mutandis to Debt Settlement Proceedings and Public Administration, cf. Section 7-3a(1)(2) of the CR Act and the discussion in paragraph 3.2 above. When considering whether this exemption is applicable, a first question is whether Derivatives per se is of a nature that entitles LCH to terminate outstanding contracts. If they are not, a second question is whether LCH's role as a CCP affects this position. These two questions are discussed below.

The question of whether Derivatives per se are of a nature that entitles a solvent counterparty to terminate outstanding contracts in the event of the insolvency of its counterparty is not directly touched upon by the CR Act or its preparatory works. The preparatory works of the CR Act do however provide general guidance on the application of the exception in Section 7-3(2)(1) by stating that it firstly applies where the contract is of a type where the solvency of the counterparty was a relevant premise for the solvent party's entry into of the agreement. Secondly, the exception may apply where the contract presupposes the personal performance of the insolvent party. Based upon this, Norwegian legal scholars have argued that neither interest rate swaps nor currency swaps are contracts

which can be terminated due to the nature of the agreement. The reason for this point of view is that the element of credit in interest rate or currency swaps is not the dominating element of the contract. Accordingly, such swaps are not comparable with the granting of a loan, which the preparatory works refers to as an example of a contract that may be terminated due to the borrower's insolvency. However, the terms of Derivatives other than interest rate or currency swaps may contain a greater element of credit, and a case could be made for recognising Section 7-3(2)(1) of the CR Act as applicable to those Derivatives. In any event, due to the vague wording of Section 7-3(2)(1) and its preparatory works, it is not possible to conclude with absolute certainty whether the solvent party to a particular Derivative contract will be entitled to terminate it due to the opening of Insolvency Proceedings in respect of its counterparty.

The question of whether LCH's role as a CCP affects the above position has not to our knowledge been addressed in any preparatory works or legal literature. It could be argued that the CCP's role as an intermediary makes the solvency of its counterparties a more essential premise for the entry into of contracts, as when a CCP does not receive payments under a contract with one Clearing Member, this will expose the CCP to market risk under the corresponding contract with another Clearing Member. However, due to the vague wording of Section 7-3(2)(1) of the CR Act and the lack of other sources addressing this specific question, we are also here unable to give the opinion that 7-3(2)(1) will entitle LCH to terminate its contracts with Clearing Members who have become Defaulters due to being subject to Insolvency Proceedings.

(ii) The PS Act

Under Section 4-2(1) of the PS Act, agreements regarding netting are enforceable against a Norwegian participant in Securities Settlement Systems regardless of whether Insolvency Proceedings or Reorganisation Measures are opened in such participant, provided that the Contract is entered into the system prior to the opening of insolvency proceedings. Netting is defined as the conversion of transfer orders between two or more participants to one net claim or one net obligation, cf. Section 1-3 of the PS Act.

As explained in paragraph 5.1 below, LCH will be able to benefit from the protections in the PS Act in relation to a Relevant Clearing Member if certain conditions, as further described at paragraph 5.1 below, are met.

One question that arises in this context is which contractual provisions are considered netting provisions for the purposes of Section 4-2(1) of the PS Act and therefore enforceable regardless of the opening of Insolvency Proceedings of a Clearing Member. The definition of "netting" contained in Section 1-3, as referred above, can be taken to imply that the PS Act refers to a procedure whereby the Perfected Contracts are terminated and the net sum of the gains and losses of the parties thereafter are calculated. In our opinion, neither the definition of "netting" in the SFD nor the preparatory works of the PS Act suggest a narrower interpretation. Our opinion is therefore that Rule 8 will be enforceable pursuant to Section 4-2(1) of the PS Act only to the extent it operates to the effect of terminating outstanding Transfer Orders and producing a net sum on the basis of the value of the Parties' obligations under the Contracts. Conversely, due to the lack of legal basis for an exemption from

Sections 7-3 and 7-3a of the CR Act, the termination of outstanding Perfected Contracts without a subsequent settlement based on the netting of the value of the Perfected Contracts would not be enforceable. Our understanding is that where Rule 6 of the Default Rules provides for the termination, close-out and re-establishment of contracts, this implies that the contracts are terminated and the gains/losses of LCH resulting from the re-establishment of contracts are taken into account for the purposes of Rule 8 of the Default Rules.

Based on this understanding, it is our opinion that termination and close-out of contracts pursuant to item (b) and item (h)(v) of Rule 6 of the Default Rules will be effective despite the opening of Insolvency Proceedings. This also applies to the action referred to in item (k) of Rule 6 of the Default Rules. On balance therefore, of the actions in Rule 6 that result in the termination of Contracts, only the actions in items (b), (h)(v) and (k) of Rule 6 are likely to be available to LCH once Insolvency Proceedings have been commenced.

To the extent the provisions in the Default Rules providing for the termination and netting of Contracts are enforceable pursuant to Section 4-2(1) of the PS Act, the net sum will be a financial obligation which may be subject to a financial collateral arrangement as described in paragraph 3.2.2 above. Financial Collateral transferred in order to secure the net obligation of the Relevant Clearing Member may therefore be set-off against the net amount due from the Relevant Clearing Member to LCH.

(iii) The right to set-off other amounts than those due under Transfer Orders

As stated above, it is only the netting of Transfer Orders which is enforceable pursuant to Section 4-2(1) of the PS Act. Rule 8(a) however appears to go further than this, by providing that amounts other than those owing under transfer orders, such as amounts due under the Regulations, any sum due in respect of any breach of the Regulations and/or any amount due from the Defaulter to the Clearing House in respect of any Treasury Contract (“**Other Amounts**”) will also be taken into account when netting the obligations of the Clearing House and the Defaulter. Section 4-2(1) of the PS Act does not guarantee that exercising the right of set-off will be effective in relation to Other Amounts. To what extent Other Amounts may be off-set against the claim of the Defaulter in the event that a net amount is due to the Defaulter following the close-out of the Contracts will therefore be regulated by Section 8-1 of the CR Act.

Section 8-1 of the CR Act provides (office translation):

“A party which at the time of commencement of the insolvency proceedings holds a claim against the debtor that may be filed with the insolvency estate, may off-set the claim with its full amount against a claim which at that time is held by the debtor, but forms part of the insolvency estate.

Set-off may not take place if set-off due to the nature of the claims would have been prevented if the debtor was still solvent. The fact that the counterclaim relates to other means than monies, or becomes due after the claim is due, does nevertheless not exclude set-off. Set-off may however not be effected if the debtor’s claim fell due prior to the

commencement of insolvency proceedings and the counterclaim falls due after this point of time.”

In the discussions below, the claim against which the Non-Defaulting Party intends to exercise set-off is referred to as the “claim” or “claims”, while the Non-Defaulting Party’s claim is referred to as the “counterclaim” or “counterclaims”.

As it will appear from the wording of Section 8-1 of the CR Act, set-off is firstly conditional upon the claims being “a claim which at [the time of commencement of the Insolvency Proceedings] is held by the debtor”, thus allowing the Non-Defaulting Party to off-set its counterclaims against such claims. Secondly, the counterclaim(s) must be claims held at the time of commencement of the insolvency proceedings that may be filed with the insolvency estate. Thirdly, set-off must not have been prevented if the debtor was still solvent.

As regards the requirement that the claim was held by the debtor at the opening of insolvency proceedings, the main implication is that claims arising due to the Insolvency Estate exercising its step-in right and performing contracts may not be settled by set-off. To the extent contracts are closed-out pursuant to Section 4-2(1) of the PS Act, this will not be the case, and therefore exercising set-off against a net amount owed by LCH to the Defaulter under Perfected Contracts will satisfy this condition.

As regards the requirement that the counterclaims must be claims held at the time of commencement of the insolvency proceedings that may be filed with the insolvency estate, this covers claims against the debtor which were due and payable at the opening of the proceedings, as well as claims that at the opening of Bankruptcy Proceedings have not yet matured or are contingent on events that have not occurred as of that date, cf. Sections 6-1 and 6-2 of the CR Act. There seems to be a consensus among legal commentators that counterclaims arising out of agreements concluded with the debtor prior to the opening of insolvency proceedings are to be considered as being held by the solvent party at the time of opening. It is however not possible for us to give a more specific opinion on whether or not Other Amounts will be eligible for set-off against a claim, as this will vary according to the grounds for the claim.

As regards the requirement that neither the claim nor the counterclaim is of a nature which would have precluded set-off if the Defaulting Party was solvent, the preparatory works of the CR Act states that whether or not this is the case depends on what is agreed between the parties and the non-statutory rules of law governing set-off. The common position taken by Norwegian legal scholars is that if the solvent party pursuant to agreement would have a right of set-off if the debtor was solvent, set-off may be exercised to the same extent towards the insolvency estate of the debtor. The insolvency estate will however not have to respect an agreement which gives the solvent party a wider right of set-off upon the bankruptcy of the debtor. Our position is consistent with this view. As the Default Rules contemplate set-off following the Clearing Member becoming a Defaulter, regardless of whether this is due to the insolvency of the Clearing Member or not, our view is that the nature of the claim and the counterclaim do not prevent set-off when the Defaulter is solvent.

On balance, our view is that LCH can take the termination actions listed in (i) - (vii) above in relation to Other Amounts, save with respect to claims from the Insolvency Estate against LCH due to the Insolvency Estate exercising its step-in right and performing contracts.

Resolution

In case of Resolution, Section 20-34 of the Financial Undertakings Act implements Art. 68 of BRRD to the effect that no enforcement action can be taken under a contract with a BRRD Entity which continues to perform its obligations thereunder notwithstanding the implementation of crisis prevention measures or crisis management measures. Section 20-34 further empowers the FSAN to terminate or amend the BRRD Entity's contracts as necessary to meet the objectives of the Resolution, subject to certain limitations. However, the FSAN's powers to suspend payments and termination rights under contracts do not extend to Perfected Contracts under a Securities Settlement System to which the PS Act applies. Provided that LCH has been duly notified to the European Commission in accordance with the SFD, it will qualify as a Securities Settlement System to which the PS Act applies. Following Brexit, LCH's status under the PS Act will depend on whether the conditions described at paragraph 5.1 below are met.

(c) The necessity/desirability of Automatic Early Termination

In cases where a solvent party is not able to rely on special legislation, such as Section 4-2 of the PS Act, the question of whether automatic early termination events are effective under Norwegian insolvency law, i.e. having the effect that agreements are considered as terminated as of the occurrence of events specified as such, to the detriment of the step-in right of the insolvency estate as discussed in this paragraph 3.2.3, is not addressed under Norwegian statutory law. The question has however been subject to some debate in Norwegian legal literature. The background for the discussion is that the preparatory works of the CR Act state that an effective termination prior to the opening of Insolvency Proceedings precludes the insolvency estate from stepping into the agreement, and this regardless of the grounds for the termination. If an automatic early termination clause, purporting to be effective at a time prior to the opening of Insolvency Proceedings, is recognised as effective under the CR Act, the relevant agreement would thus be considered as terminated prior to the opening of Insolvency Proceedings and therefore precluding the insolvency estate from stepping into the agreement.

The view in Norwegian legal literature is, however, that automatic early termination clauses are not effective. This view is based upon the rationale given in the preparatory works of the CR Act for making the effectiveness of the termination of the agreements to the detriment of the step-in right of the Insolvency Estate conditional upon whether the notice of termination actually has been presented to the debtor prior to the opening of Insolvency Proceedings: If the non-defaulting party actually wishes to terminate the agreement on grounds of an event of default, this has to be actually done at this stage, and not at a later stage when Insolvency Proceedings are opened. Our opinion is that Norwegian courts are most likely to take the same position, and we therefore do not deem Automatic Early Termination Events to be enforceable outside the situations where the special legislation in the PS Act applies. When the PS Act applies, Automatic Early Termination Events do not add

to LCH's rights upon the insolvency of a Relevant Clearing Member. Therefore we do not deem Automatic Early Termination Events to be strictly necessary.

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

BAHR response: Section 5-9 of the CR Act contains a general rule similar to actio pauliana, pursuant to which a transaction which (i) improperly gives preference to one creditor at the expense of the others, (ii) prevents the debtor's assets from being used to cover the creditor's claims, or (iii) increases the debtor's liabilities in a manner which is detrimental to the creditors, may be avoided if the debtor's financial situation was weak or became seriously weakened by the transaction. The transactions may be avoided where the other party knew or should have known of the debtor's financial difficulties and the circumstances which rendered the transaction improper. The provision applies for transactions completed within the period starting 10 years prior to the Date of Filing.

Section 5-7 of the CR Act contains a rule pursuant to which the creation of a pledge or other security may be avoided if (a) the pledge or security concerns debt which the debtor incurred prior to the security right was agreed or (b) the security was not perfected without undue delay after the debt was incurred may be subject to claw back, in both cases provided that the security right was perfected within the period starting three months prior to the petition for Debt Settlement Proceedings or Bankruptcy Proceedings was received by the court. However, Section 4-4 of the PS Act states that Collateral granted to a central bank, operator or participant in a Securities Settlement System cannot be avoided based on Section 5-7 of the CR Act. It is therefore our opinion that Collateral taken by LCH in relation to Contracts entered into with a Relevant Clearing Member cannot be avoided based on Section 5-7 of the CR Act.

Sections 5-7 and 5-9 of the CR Act are different claw-back rules, which are not mutually exclusive. If the conditions for claw-back under Section 5-9 are met, claw-back under this rule is possible. In our opinion, it is unlikely that the clearing services offered by LCH could become subject to claw-back under Section 5-9, but it cannot be ruled out.

- 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?*

BAHR response: There is no such legislation of which we are aware.

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

BAHR response: No. Claims against a Relevant Clearing Member are converted into NOK for value at the Date of Filing.

4. Client Clearing

Exempting Client Clearing Rule

- 4.1 *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.*

BAHR response: As far as we are aware, there is no Exempting Client Clearing Rule available under substantive Norwegian law. However, please see paragraph 4.4 for a discussion on whether the rights and obligations arising from, or in connection with, the participation of that Relevant Clearing Member within the LCH system would be determined by the application of substantive English law, being the law governing that system.

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 3.12 to 3.14.

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) that you consider to be relevant to that matter; and (iii) provide a response to questions 3.12 to 3.14.

Default Outside Insolvency Proceedings or Reorganisation Measures

- 4.2 *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?*

BAHR response: A Relevant Clearing Member is contractually bound to the Opinion Documents by way of its agreement to the Clearing Membership Agreement. In the absence of Insolvency Proceedings or Reorganisation Measures being initiated against a defaulting Relevant Clearing Member, the contractual arrangements supporting the Client Clearing Arrangements should be effective in their own right. On this basis, neither the Relevant Clearing Member nor any other person should be able to successfully challenge the porting

of the relevant Client Contracts and Account Balance by LCH, where Insolvency Proceedings or Reorganisation Measures have not been commenced.

- 4.3 *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?*

BAHR response: Please see our response in paragraph 4.2 above. On this basis, neither the Relevant Clearing Member nor any other person should be able to successfully challenge the return by LCH of the Client Clearing Entitlement to the relevant Clearing Client or Defaulter, where Insolvency Proceedings or Reorganisation Measures have not been commenced.

Insolvency-related Default

- 4.4 *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?*

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

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

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

- (i) any law, regulation or statutory provision (having the force of law) of a governmental authority, the effect of which is to protect the operation of the LCH Rules, including in particular the Client Clearing Annex of the Default Rules, from challenge under the insolvency laws applicable to the Relevant Clearing Member (any such provision, an "Exempting Client Clearing Rule"); or

- (ii) if no Exempting Client Clearing Rule would apply to a Relevant Clearing Member, the Security Deed (as defined below). Clearing Members in respect of whom a suitable Exempting Client Clearing Rule is not available and who wish to offer client clearing are required to enter into a security deed (the "**Security Deed**") in favour of each of their Clearing Clients. Under the terms of the Security Deed, the Relevant Clearing Member grants a security interest in favour of its Clearing Client over the receivable from LCH in respect of assets and positions held in an account with LCH on the relevant Clearing Client's behalf.

The LCH Rulebook permits LCH to designate a Clearing Member as an "Exempt Clearing Member" if, in its sole determination, an Exempting Client Clearing Rule would apply to a Relevant Clearing Member upon it becoming a Defaulter.

In accordance with the provisions of the Client Clearing Annex an Exempt Clearing Member must either:

- (i) pay or deliver to or to the order of LCH the Account Balances of those of its Clearing Clients whose contracts are ported to a Backup Clearing Member; or
- (ii) pay or deliver to or to the order of LCH the Client Clearing Entitlements of its Individual Segregated Account Clients, Affiliated Omnibus Segregated Clearing Clients and Identified Omnibus Segregated Clearing Clients whose contracts are closed out and liquidated,

which obligations constitute an "Undertaking to Pay and Deliver" between the Exempt Client Clearing Member and LCH and are secured under the Deed of Charge. The Undertaking to Pay and Deliver applies to those Clearing Clients who are Individual Segregated Account Clearing Clients and those Clearing Clients that are all Identified Omnibus Segregated Clearing Clients or Affiliated Omnibus Segregated Clearing Clients comprising a single Omnibus Segregated Account who have appointed a single Backup Clearing Member. It does not apply to Non-Identified Omnibus Segregated Clearing Clients. For these Clearing Clients an "Aggregate Omnibus Client Clearing Entitlement" will always be returned to the Defaulting Clearing Member, regardless of whether the Defaulting Clearing Member is an Exempt Clearing Member.

If a Relevant Clearing Member were designated as an Exempt Client Clearing Member, then the operation of the Client Clearing Annex of the Default Rules should be capable of being protected from challenge under the insolvency laws of Norway, being the laws applicable to the Relevant Clearing Member upon its insolvency, and the entering into of a Security Deed would not be necessary.

If a Clearing Member does not qualify as an "Exempt Clearing Member" then it must enter into a Security Deed in respect of each Clearing Client which is an Individual Segregated Account Client, Affiliated Omnibus Segregated Clearing Client or Identified Omnibus Segregated Clearing Client.

Article 8 of the SFD provides "*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*". It is our opinion that this provision imposes an obligation on Norway to ensure that, in the event of opening of insolvency proceedings in Norway in relation to a participant in a system, the effect of such insolvency proceedings on the rights and obligations of that participant is determined by the law governing that system. As is evidenced by the Recitals of the SFD, in particular Recital 17, Article 8 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. Furthermore, pursuant to Article 10 of the SFD, Member States shall specify the systems, and the respective system operators, included in the scope of that directive.

For the purposes of giving this opinion letter, we understand that LCH has been designated by the United Kingdom as a Securities Settlement System for the purposes of the SFD, which specification applies to all of the LCH Services. The SFD has been transposed into Norwegian law through the provisions of the PS Act, which following 1 January 2019 also implements Recital 7. This means that the protective measures provided by the PS Act apply accordingly to systems governed by the laws of a country outside the EEA, provided that certain conditions, as further described at paragraph 5.1 below, have been met. However, since implementation of Recital 7 in Member State's national law is voluntary under the SFD, Norway's treaty obligation under Article 8 does not extend to participation in LCH's Securities Settlement System following Brexit (which would then constitute a "third country system" in the context of the SFD). On this basis one could argue that the discussion below, which brings us to the conclusion that the PS Act must be interpreted in conformity with Article 8 to honour Norway's treaty obligation, would no longer be relevant to LCH after Brexit, the rationale for drawing such conclusion being that the argument of conformity does not apply beyond the scope of the obligation itself. That being said, there is nothing in the preparatory works of the amendments to the PS Act which implements Recital 7 in Norwegian law to suggest that the legislature had any intention of narrowing down the scope of protective measures afforded by the PS Act to third country systems. Rather, the reason for implementing Recital 7 in Norwegian law in the first place, was to facilitate continued participation by Norwegian participants in UK systems after Brexit by affording operators and participants in those systems the same level of protection which they have benefitted from under the PS Act prior to the transposition of Recital 7. Against this background, we find the discussion below to be equally relevant to a Relevant Clearing Member's participation in LCH's Securities Settlement System after Brexit, provided always that the conditions described at paragraph 5.1 below have been met in relation to each Relevant Clearing Member prior to the opening of Insolvency Proceedings.

Pursuant to Article 2(j) of the SFD, 'insolvency proceedings' means any collective measure provided for in the law of a Member State, or a third country, either to wind up the participant or to reorganise it, where such measure involves the suspending of, or imposing limitations on, transfers or payments. Bankruptcy Proceedings and Public Administration will be deemed as insolvency proceedings for these purposes. This means that Norway is obliged under the SFD to ensure that the effect of these proceedings on the participation of a Norwegian participant will be determined by the law governing that system, provided that

the system falls within the mandatory scope of the SFD. As noted above, LCH will not fall within the mandatory scope of the SFD following a hard Brexit, after which it will constitute a third country system for the purposes of the SFD. For such systems, the SFD leaves it to Member States to decide whether and to what extent the protections afforded thereunder shall be extended to third country systems. However, given the Norwegian legislature's clear intention to procure equivalent protection for UK systems in a hard Brexit scenario through the implementation of Recital 7, we see no reason to adopt a narrower interpretation of the protective measures afforded under Chapter 4 of the PS Act in relation to a third country system.

Pursuant to Subsection 2 of Section 4-3 of the PS Act (which implements the SFD in Norwegian law), the law elected in accordance with Subsection 1 of Section 4-3 of the PS Act by the participants in a system as governing that system determines the rights and obligations of an insolvent participant in its capacity as a participant in the system. Subsection 1 of Section 4-3 provides that the participant may only elect the law of a state where at least one of the participants has its main office.

Uncertainty of the scope of these provisions arises due to Section 4-1 of the PS Act, from which it follows that the provisions of Chapter 4 of the PS Act, this including Section 4-3, is only applicable to Securities Settlement Systems with permission from the FSAN and which pursuant to the election of its participants are governed by Norwegian law. A literal interpretation of Section 4-1 would render Section 4-3 non-applicable to LCH.

The preparatory works of the PS Act prior to implementation of Recital 7 (in effect as of 1 January 2019), did not shed any light on the Norwegian legislature's interpretation of Article 8 of the SFD or the question of whether the effect of Section 4-1 was intentional. The preparatory works of the amendments to the PS Act to implement Recital 7 do not explicitly comment on this question either, but Subsection 1 of Section 4-3 of the PS Act was amended so that the participants may now elect the law of any state where at least one of the participants has its main office. Prior to 1 January 2019 and implementation of Recital 7, the same provision only opened up for electing the law of an EEA State. Furthermore, certain comments in the preparatory works of the amendments to the PS Act to implement Recital 7 can be taken to imply that Section 4-3 was meant to, and still is meant to, apply also to Securities Settlement Systems governed by the laws of another state than Norway (office translation)³:

“It follows from Subsection 1 of Section 4-3 that the participants in the system may only elect the laws of an EEA State to govern the system in which at least one of them has its head office. Pursuant to the provision in Subsection 2, this governing law will be decisive for determining the rights and obligations of an insolvent participant which arises from, or in connection with, the participation of that participant in the system.

In order for the law, which has been elected by the participants to govern the system, to apply to a Norwegian participant who participates in a system outside the EEA, it is proposed

³ Prop. 1 LS (2018-2019) page 324.

that the choice of law provision in Section 4-3 is extended to apply also to the laws of states outside the EEA.” (Our underlining)

In our opinion, the above extract from the preparatory works and the amendment of Section 4-3 to implement Recital 7, clearly indicates that the legislature has intended to transpose Article 8 into Norwegian law and furthermore, to extend this protective measure to third country systems notified and published in accordance with the PS Act, notwithstanding the conflict which a literal interpretation of Section 4-1 seemingly creates.

Nevertheless, there still appears to be a conflict between, on the one hand, Norway's obligations pursuant to the EEA Agreement and, on the other, the wording of Section 4-1 taken together with Section 4-3 of PS Act. Under Norwegian law, there exists a principle pursuant to which Norwegian law shall be interpreted in conformity with EEA law to the extent possible. In cases of conflict, it follows from a judgment of the Norwegian Supreme Court that the plain meaning of Norwegian statutory provisions will carry more weight where such provision governs the relationship between private parties than where the statutory provision governs the relationship between the government and private parties and EEA law confers rights upon private parties. This is due to the consideration of legal certainty, meaning that private parties should be able to rely on the plain meaning of Norwegian statutes reflects the legal situation. Although statutory provisions governing the effects of Insolvency Proceedings governs the relationship between private parties, namely the insolvency estate/the debtor under Public Administration (as applicable) and its solvent counterparties, we hold the view that the said consideration does not carry as much weight as in relation to other provision governing private relations in cases where the EEA law is to the benefit of the solvent party. This is due to the simple fact that an insolvency estate/the debtor under Public Administration is at the time of entry into the affected agreements incapable of establishing any expectations as to the effects of Insolvency Proceedings on the contracts of the debtor, as at that time the insolvency estate does not yet exist and the administration board of the debtor under Public Administration has not yet been appointed. Having regard to, firstly, that considerations regarding legal certainty does not offer a weighty counter-argument against interpreting Norwegian law in conformity with Article 8 of the SFD and, secondly, that there exists no evidence in the preparatory works that the Norwegian legislature had an express intention of non-compliance with Article 8, our best opinion is therefore that Norwegian law will be interpreted in conformity with Article 8 of the SFD, and therefore that the effects of Insolvency Proceedings on the rights and obligations arising from, or in connection with, the participation of a participant in LCH will be governed by English law.

We are therefore of the opinion that, in the event of Insolvency Proceedings being commenced against a Relevant Clearing Member, such that it is designated as a Defaulter (whether due to the delivery of a Default Notice or (if applicable) the occurrence of an Automatic Early Termination Event), the effect of Subsection 2 of Section 4-3 of the PS Act (the “Carve Out Rule”) and designation of LCH as a system is that the rights and obligations arising from, or in connection with, the participation of that Relevant Clearing Member within the LCH system would be determined by the application of substantive English law, being the law governing that system.

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

It is questionable whether the Carve Out Rule would also capture the mechanism of the Security Deed. However, the mechanism of the Security Deed is intended to operate only in the absence of an Exempting Client Clearing Rule and on the basis of our above opinion would not therefore be necessary in respect of Relevant Clearing Members.

- 4.5 *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?*

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

Subsection 2 of Section 4-3 of the PS Act states that the law governing the system shall also govern the "*rights and obligations [...] as a participant in the system*" of the Defaulter in the event of the Defaulter's insolvency. It is our view that LCH's right to return the Client Clearing Entitlement is an "*obligation*" of the Defaulter for the purposes of Section 4-3 of the PS Act, and that this will therefore be governed by the law governing the Service, i.e. the laws of England and Wales.

Accordingly, we are of the opinion that if LCH were to seek to return the Client Clearing Entitlement to the relevant Clearing Client directly, or to the Defaulter for the account of such client, then neither an insolvency officer nor an Administration Board appointed to the Defaulter could successfully challenge the actions of LCH and claim for the amount of Client

Clearing Entitlement, provided and to the extent that such challenge is not possible under substantive English law.

Reorganisation Measures

4.6 *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?*

BAHR response: Resolution would, in our view, be deemed as insolvency proceedings for the purposes of the SFD. Accordingly, the opinions expressed in paragraph 4.4 above would apply equally in respect of a Relevant Clearing Member being designated a Defaulter following commencement of Resolution of that Relevant Clearing Member.

It is our opinion that Debt Settlement Proceedings do not constitute insolvency proceedings for the purposes of the SFD. This would mean that Norway is not pursuant to EEA law obliged to ensure that the effects of Debt Settlement Proceedings are governed by the law governing the Securities Settlement System.

Furthermore, Subsection 2 of 4-3 of the PS Act states that the law governing the system determines the rights and obligations of an *insolvent* participant in the system. This suggests that Subsection 2 of Section 4-3 does not affect the law governing the effects of Debt Settlement Proceedings, as it is Insolvency Proceedings which are applicable in the event of insolvency. Our opinion is therefore that the effects of the opening of Debt Settlement Proceedings will be governed by Norwegian law, and consequently an Exempting Client Clearing Rule is not available. It should however be reiterated that, as stated in paragraph 3.2, BRRD Entities can only be subject to Resolution and Public Administration, and not Debt Settlement Proceedings. Accordingly, the opinions expressed in this paragraph 4.6 will only be of relevance where the Relevant Clearing Member is not a BRRD Entity.

Our understanding is that porting of Client Contracts may be effectuated by either (i) a close-out of the relevant Client Contracts between LCH and the Defaulter followed by the replication of such Contracts (by the opening of new Client Contracts on the same terms) between LCH and the Backup Clearing Member; or (ii) a transfer of the relevant Client Contracts (in the form of open positions and without close-out) from the Defaulter to a Backup Clearing Member. The effectiveness of these two forms of porting is discussed separately below.

(a) *Porting by close-out of relevant Client Contracts*

Where the porting of Client Contracts is effectuated by a close-out of the relevant Client Contracts between LCH and the defaulting clearing member, it is, following the discussion in paragraph 3.2.3(b)(ii) above, our opinion that LCH may close-out the Client Contracts

pursuant to Section 4-2(1) of the PS Act regardless of the 'opening of insolvency' proceedings (as this term is defined in the PS Act). As the definition of the term 'opening of insolvency proceedings' contained in Section 1-3 of the PS Act comprises the opening of Debt Settlement Proceedings, Section 4-2(1) of the PS Act ensures the enforceability of porting of the relevant Client Contracts, regardless of the opening of such proceedings. Furthermore, following the discussion in paragraph 4.8 below, it is our opinion that the Security Deed will be enforceable. Provided that the Client pursuant to the contractual terms of the Security Deed is entitled to realise the charge by requiring the transfer of the Account Balance to a Backup Clearing Member, it is therefore our opinion that an insolvency officer appointed to the Defaulter or any other person could not successfully challenge the actions of LCH and claim for the amount of the Account Balance.

(b) *Porting by transfer of relevant Client Contracts*

Our understanding is that porting by transfer of open positions results in the discharge of all of the rights and obligations of the Defaulter and LCH, without this resulting in any amount being due to or owed by LCH for the net loss or gain (as the case may be) resulting from the discharge of its rights and obligations. The consequence of this is that the porting will be viewed as a termination for the purposes of Section 7-3a of the CR Act, which, as discussed in paragraph 3.2.3(b) above, requires the existence of an applicable exemption. Due to the fact that the agreements are not closed out, a clause providing for the transfer of open Relevant Contracts will not be deemed to be a netting provision for the purposes of Section 4-2(1) of the PS Act, cf. the discussion in paragraph 3.2.3(b)(ii) above. While it cannot be ruled out that LCH will be entitled to terminate certain Contracts pursuant to Section 7-3(2)(1) of the CR Act cf. Section 7-3a(2) of the CR Act, we are not able to give a clear opinion that this will be the case, cf. the discussion in paragraph 3.2.3(b)(i) above.

4.7 *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?*

BAHR response: The opinions expressed in paragraph 4.5 above would apply equally in respect of a Relevant Clearing Member being designated a Defaulter following commencement of Resolution of that Relevant Clearing Member.

Debt Settlement Proceedings do not entail a general seizure of the Relevant Clearing Member's assets. Accordingly, no representative appointed to reorganise/manage the Defaulter could successfully challenge the actions of LCH and claim for the amount of the Client Clearing Entitlement.

Security Deed

- 4.8 *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?*

BAHR response: As stated in paragraph 4.4 and 4.6 above, we are of the opinion that, in the event of Insolvency Proceedings or Resolution being commenced against a Relevant Clearing Member, such that it is designated as a Defaulter (whether due to the delivery of a Default Notice or (if applicable) the occurrence of an Automatic Early Termination Event), the effect of the Carve Out Rule and designation of LCH as a system is that the rights and obligations arising from, or in connection with, the participation of that Relevant Clearing Member within the LCH system would be determined by the application of substantive English law, being the law governing that system. It is however unclear whether the Carve Out Rule, as interpreted in conformity with Article 8 of the SFD, applies to Debt Settlement Proceedings. Therefore a Security Deed may be required to prevent a challenge to the actions of LCH in the event that a Relevant Clearing Member is subject to Debt Settlement Proceedings.

Please note however that a BRRD Entity cannot be subject to Debt Settlement Proceedings. Accordingly, in our view it is unnecessary to require a Relevant Clearing Member which is a BRRD Entity to enter into a Security Deed.

Our understanding of the Security Deed, read in conjunction with Regulation 20 of the General Regulations, is that the following applies in respect of Collateral transferred by the relevant Clearing Member to LCH: Save in the case of non-cash Collateral, the transfer of Collateral will be effectuated as a title-transfer. In the case of non-cash Collateral, it will be held by LCH as custodian for the Clearing Member. This would mean that the security interest created by the Clearing Member in favour of the relevant Clearing Client in cash Collateral is a security interest in the contingent monetary claim the Clearing Member holds against LCH. Conversely, the security interest created in the non-cash Collateral would be a security interest in the non-cash Collateral itself.

Outside of Debt Settlement Proceedings and Insolvency Proceedings, the Relevant Clearing Member would be contractually bound to respect the terms of the Security Deed.

Once Debt Settlement Proceedings and Insolvency Proceedings have been commenced, the question of which law that governs the effects of opening of such proceedings in Norway on the security arrangements of the debtor is a question of Norwegian international private law. Which law that Norwegian international private law designates as applicable to this question varies from asset class to asset class. As per the definition of Collateral in the General Regulations, we understand that only two types of assets may be used as Collateral: cash and securities. Which law that provides the applicable effects on security arrangements following the opening of Debt Settlement Proceedings and Insolvency Proceedings in Norway is discussed below separately for each asset class.

- (a) *Cash*

As referred above, our understanding is that in relation to the part of the Relevant Client Clearing Return or the Relevant Account Property (as applicable) consisting of cash, the security created is in the Clearing Members contingent monetary claim for repayment. This would mean that the security interest under the Security Deed is created in a monetary claim. The question of which law that regulates the effect of Debt Settlement Proceedings and Insolvency Proceedings on security arrangements in monetary claims is due to lack of statutory provisions or court precedents uncertain under Norwegian international private law. Legal scholars have presented the alternatives (i) the law governing the claim(s) and (ii) the law of the chargor's country of incorporation. A recent Norwegian Supreme Court judgment addressed the issue in respect of security interests over trade receivables and found that the law of the home state of the transferor/security grantor is the relevant system of law. The Supreme Court's reasoning suggests that it may adopt the same approach to private international law issues concerning the validity and effects of insolvency proceedings on security interests over cash accounts. In the case of a Clearing Member incorporated in Norway, this would mean that either Norwegian or English law would govern the effects of the opening of Debt Settlement Proceedings and Insolvency Proceedings on the security arrangement. It should be noted that some have argued that the law applicable to issues concerning cash balances is the law governing the account agreement, the Supreme Court judgment notwithstanding.

Regardless of whether it is Norwegian or English law that is applicable the security interest established by the Security Deed should be effective. We are of this opinion because the Security Deed clearly indicates that the Parties' intention is to establish a security interest over an asset which can also be legally assigned under Norwegian law. Furthermore, the perfection requirements for such security (notification to LCH) correspond under Norwegian and English law, meaning that the security interest established under the Security Deed would be perfected even though Norwegian courts should hold that Norwegian law governs the Security Deed in Debt Settlement Proceedings and Insolvency Proceedings.

(b) *Securities*

In relation to the part of the Relevant Client Clearing Return or the Relevant Account Property (as applicable) consisting of securities, Section 9 of the FC Act implements the conflict of laws rule contained in Article 9 of Directive 2002/47/EC (as amended). This means that *inter alia* the requirements for perfection and provision of book entry securities collateral under financial collateral arrangements, and more generally the completion of the steps necessary to render such an arrangement and provision effective against third parties, is governed by the law of the country in which the relevant account is maintained. According to our understanding, this would imply England in relation to the Security Deed.

4.9 *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?*

BAHR response:

(a) *Monetary claims*

In the event Norwegian law applies to the effects of the opening of Insolvency Proceedings in Norway, no perfection requirements need to be taken under the laws of Norway other than notification to the debtor of the Client Clearing Entitlement, which we understand is already provided for under the Security Deed.

(b) *Securities*

No additional perfection steps are required under the laws of Norway in order for the Security Deed to be effective.

4.10 *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?*

BAHR response: FSAN may in connection with the taking of resolution actions impose a short-term prohibition against the counterparties of a BRRD entity terminating contracts with the entity and enforcing security interests over its assets. Such a prohibition could last until midnight the first business day following the FSAN making such an order. While the operation of Securities Settlement Systems is exempted from the scope of this power, the rights of clearing clients are not. Accordingly, a resolution may, at least in theory, involve a short stay on the enforcement of a Security Deed made by a BRRD Entity.

If a Relevant Clearing Member that is not a BRRD Entity is placed under Debt Settlement Proceedings, any enforcement of security rights over its assets during the first six months of the Debt Settlement Proceedings is subject to restructuring board's consent. This six month restriction period runs from the opening of Debt Settlement Proceedings, and is not subject to extension. The restructuring board could also consent to enforcement of security although the stay period has not expired. It should be noted that only actual enforcement actions (e.g. forced sale) is subject to the six month restriction period; preparatory actions such as petitions, court hearings and all other actions necessary to lay the ground for an actual enforcement action can be carried out unhindered of the restriction.

However, the above-mentioned stay period does not apply to security granted over monetary claims and Financial Collateral. Our understanding is that the Security Deed establishes, in favour of the Clearing Client, a security interest over the Relevant Clearing Member's claim against LCH for the relevant Client Clearing Entitlement, which consists of monetary claims and Financial Collateral. Based on this understanding, no stay will apply to the enforcement of security established over these assets under the Security Deed. The six month stay would however apply to other types of collateral (if any) granted under the Security Deed.

General

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

BAHR response: We have not identified any such issues.

5. Settlement Finality

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

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

BAHR response: The SFD, including Recital 7 following 1 January 2019, has been implemented in Norwegian law through the provisions of the PS Act. This entails that the protections provided by the PS Act apply equally to systems governed by the laws of a country outside the EEA, provided that certain conditions are met prior to the commencement of Insolvency Proceedings or Reorganisation Measures against the Relevant Clearing Member. These conditions are described in detail below.

Following Brexit, in order for LCH to benefit from the protections afforded to Securities Settlement Systems under the PS Act in relation to a Relevant Clearing Member, the following two conditions must be met prior to commencement of Insolvency Proceedings or Reorganisation Measures against the Relevant Clearing Member:

- (i) the Relevant Clearing Member must have notified its participation in LCH to the FSAN; and
- (ii) the FSAN must have published such notice on its website.

Upon both these conditions being met, LCH will, in relation to that Relevant Clearing Member, benefit from the same protections currently afforded to it in its capacity as a Securities Settlement System governed by the laws of a country within the EEA.

- 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?*

BAHR response: As explained under paragraph 5.1 above, the protections as contemplated by Recital 7 of the SFD will be available under Norwegian law upon satisfaction of the conditions described therein.

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.*

BAHR response: See our comments under section 5.2.

* * * *

In this opinion letter, Norwegian legal concepts are described in English terms and not by their original Norwegian terms. The concepts concerned may not correspond to the concepts described by the same English terms as they exist under the laws of other jurisdictions. This opinion letter may, therefore, only be relied upon on the express condition that any issues of interpretation or liability arising hereunder will be governed by Norwegian law and be brought before a Norwegian court.

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 publicly available on the addressee's website and being disclosed 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 of such disclosure or otherwise.

Yours sincerely,

Advokatfirmaet BAHR AS



Markus Nilssen
attorney

Schedule 1 Assumptions

For the purposes of this opinion letter, we have assumed:

- (a) that the Opinion Documents are legal, valid, binding and enforceable under English law;
- (b) the compliance with all relevant perfection requirements and the effectiveness of the collateral arrangements provided for under the Deed of Charge under the law of any jurisdictions other than Norway;
- (c) that the Opinion Documents are entered into prior to the commencement of any Insolvency Proceedings against either Party;
- (d) that all transactions are entered into and all acts are performed in accordance with the terms of the Opinion Documents;
- (e) that each party to the Opinion Documents has duly executed the Opinion Documents;
- (f) that the rights and obligations of each party under the Opinion Documents are valid, binding and enforceable under the jurisdiction of each such party (other than a Relevant Clearing Member);
- (g) that there are not any other agreements, instruments or arrangements between the Parties which modify or supersede the terms of the Arrangements and/or any Opinion Document;
- (h) that the Opinion Documents have been entered into, and each of the Contracts referred to therein are carried out, by each of the Parties thereto in good faith, for the benefit of each of them respectively, on arms' length commercial terms and for the purpose of carrying on, and by way of, their respective businesses;
- (i) that the Relevant Clearing Member is an institution for the purposes of the SFD (as amended);
- (j) that any Secured Obligations (as defined in the Deed of Charge) have been incurred with respect to a Service;
- (k) that the "relevant account" (as defined in the Deed of Charge) is located in England and Wales;
- (l) that any Securities granted as Collateral will be book-entry Securities held in the "relevant account";
- (m) that each Relevant Clearing Member has good legal or other title to the assets or rights which are expressed to be subject to a security interest under the Deed of Charge;
- (n) that the Charged Property (as defined in the Deed of Charge) constitutes Financial Collateral;
- (o) that any transaction which the Deed of Charge secures or purports to secure has been duly entered into the relevant Service prior to the commencement of any Insolvency Proceedings against the relevant Clearing Member;

- (p) that there is no other agreement, instrument or other arrangement between any of the parties to the Opinion Documents which modifies or supersedes the Opinion Documents; and
- (q) that no laws other than the laws of Norway will affect any of the opinions given herein.

Schedule 2 Reservations

This opinion letter is subject to the following reservations:

- (a) Our advice is given in respect of the specific questions raised by LCH as set out in the Instructions. We express no opinion in this advice as to the validity and enforceability of any provisions of LCH's Rulebook or the Procedures not explicitly addressed in the Instructions.
- (b) We do not express any opinion as to any matters of fact.
- (c) The opinions expressed herein are confined to and given on the basis of the laws of Norway as currently in force and applied by the courts of Norway. We have made no investigation of and express no opinions as to matters under or involving the laws of any jurisdiction other than the laws of Norway.
- (d) We do not opine on any matters of tax.
- (e) Norwegian courts may require documents in foreign languages to be translated into Norwegian if such documents are to be used as evidence before Norwegian courts.
- (f) A determination, calculation or certificate of any Party to the Opinion Documents as to any matter provided for therein might in certain circumstances be held by the courts not to be conclusive if it could be shown to have an unreasonable or arbitrary basis or in the event of manifest error despite any provision in any document to the contrary.
- (g) If any document is held to contain provisions that are illegal, invalid or unenforceable, the severance of such provisions from the remaining provisions of such document will be subject to the exercise of the discretion of the Norwegian courts.
- (h) Norwegian law permits a judgement debtor to pay a judgement debt (even though denominated in a foreign currency) in Norwegian Kroner.
- (i) Claims may become time barred under limitations acts or may become subject to counterclaims, set-off or other defences.
- (j) A Norwegian court may reject the right to take proceedings in Norway if proceedings which have led or may lead to a judgement which is enforceable in Norway have already been taken in another court of competent jurisdiction within or outside Norway.
- (k) A clause in the Opinion Documents where a Relevant Clearing Member gives an irrevocable power of attorney, the irrevocability and scope of such would, for the Relevant Clearing Member, be subject to acts under such a power of attorney being in compliance with duties and obligations the Relevant Clearing Member has under Norwegian law or under contract with third parties.
- (l) This opinion letter refers to certain rules of the CR Act which attach legal effect to the opening of Debt Settlement Proceedings (or Debt Restructuring Proceedings) and Bankruptcy Proceedings. The Financial Undertakings Act does not provide any guidance as to when this

event is deemed to take place when applying the CR Act “*accordingly*” to Public Administration, cf. the discussion in paragraph 3.2 above. This issue does neither appear to have been addressed in the preparatory works of the Act, but the Act does however offer some guidance by specifying that the “*date of filing*” for the purposes of the application of the CR Act shall be deemed to be when the Norwegian Ministry of Finance resolves that the BRRD Entity shall be placed under Public Administration. As the opening of Debt Settlement Proceedings, Bankruptcy Proceedings and other proceedings regulated by the CR Act is never earlier than the “date of filing” corresponding to such proceedings, this indicates that the opening of Public Administration will not be considered to be at an earlier time than the “*date of filing*” for the Public Administration. It also seems as the most logical to consider this point in time as the opening of Public Administration for the purposes of applying the CR Act to Public Administration. Our opinion is therefore that Norwegian courts when applying the CR Act to Public Administration will most likely construe references to the opening of proceedings as when the Norwegian Ministry of Finance resolves that the BRRD Entity shall be placed under Public Administration.

- (m) The opinions herein are rendered only as of the date hereof and we assume no obligation to update or supplement this opinion letter to reflect any facts or circumstances which may hereafter come to our attention or to any changes in law which may occur.

Schedule 3 Form of Clearing Membership Agreement

Schedule 4 Form of Deed of Charge