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BY MAIL AND ELECTRONIC DELIVERY

July 31, 2018

Our Matter No. 127895.1014

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

Dear Sirs/Mesdames:

Re: Membership, Insolvency, Security, Set-off & Netting and Client Clearing – Ontario and Canadian Federal Law

You have asked us to provide advice in respect of the laws of Ontario and the federal laws of Canada 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 Sections 3 and 4 of this letter together with the corresponding responses. Terms not otherwise defined in this letter shall have the meaning given to them in the Instructions and LCH's Rulebook (as defined below).

1. TERMS OF REFERENCE

1.1 Our advice is given in respect of Clearing Members which are Canadian banks and all references to a "Canadian Clearing Member" in this letter should be construed accordingly. For these purposes a reference to a "Canadian bank" is a bank incorporated under the *Bank Act* (Canada). See Schedule I and Schedule II of the Bank Act for the list of banks (including subsidiaries of foreign banks) incorporated in Canada.1

1.2 We confirm that our advice is applicable to the Services (as defined in the Instructions).

1.3 The Ontario Securities Commission has granted LCH recognition as a clearing agency pursuant to section 22.1 of the *Securities Act* (Ontario).

1.4 SwapClear has been designated as a designated derivatives clearing and settlement system by the Bank of Canada pursuant to section 4 of the *Payment Clearing and Settlement Act* (Canada) ("**PCSA**"). The Other Services (defined below) are not so designated. LCH is not designated as a securities and derivatives clearing house under section 13.1 of the PCSA.

1.5 In this advice:

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[1] We understand that currently only Canadian banks are Clearing Members and, consequently, our advice is restricted those entities.

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

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

(c) "**Clearing Membership Agreement**" means an agreement entered into between LCH and the Canadian Clearing Member which is substantially in the form set out in Schedule 1;

(d) "**Client Contracts**" means Contracts entered into on behalf of a Clearing Client by the Clearing Member with LCH;

(e) "**Client Transactions**" means Contracts entered into between the Clearing Member and the Client which clear Client Contracts;

(f) "**Collateral**" means Securities (as such term is defined in the Deed of Charge) lodged by the Canadian Clearing Member with LCH pursuant to the Deed of Charge and includes the Charged Property (as defined in the Deed of Charge);

(g) "**Collateral Arrangements**" means the security arrangements provided for in the Rulebook pursuant to which a Canadian Clearing Member provides Collateral to LCH;

(h) the "**Commission**" means the Ontario Securities Commission;

(i) "**Contract**" means a contract as defined in the Rulebook

(j) "**Deed of Charge**" means the deed of charge entered into between a Clearing Member and LCH which is substantially in the form of the Deed of Charge set out in Schedule 2, [except that we are assuming that it will be amended to add the underlined words to section 3 - "charges and assigns absolutely..." or words to like effect;]

(k) "**Default Arrangements**" means default management procedures of LCH, provided for in the Rulebook, including, in particular, under the Default Rules and, in respect of Client Contracts, under the Client Clearing Annex to the Default Rules;

(l) "**Other Services**" means the Services other than SwapClear;

(m) "**Parties**" means LCH and a single Canadian Clearing Member to which this advice applies, and "**Party**" means either of them;

(n) **"Rulebook"** means the General Regulations, Procedures, Default Rules, Settlement Finality Regulations and the Product Specific Contract Terms and Eligibility Criteria Manual published on the LCH website as of April 26, 2016;

(o) "**Settlement Finality Regulations**" means the Financial Markets and Insolvency (Settlement Finality) Regulations 1999;

(p) "**this jurisdiction**" means the province of Ontario, Canada when referring to a geographical location and Ontario provincial law and Canadian federal law when referring to the laws of this jurisdiction; and

(q) unless the context otherwise requires, a reference to a "**paragraph**" is a reference to a paragraph in this advice.

Other definitions are set out in **Appendix B**.

1.6 The liquidation insolvency proceeding ("**Insolvency Proceedings**") that could apply to a Canadian bank is a winding up ("**Winding-up**") under the *Winding-up and Restructuring Act* (Canada) ("**WURA**"). The applicable reorganization measure is a resolution order under the

Canada Deposit Insurance Corporation Act (Canada) ("**CDIC Act**") under the control of CDIC ("**Reorganization Measures**" or "**Resolution**"). A restructuring process is also provided for in the WURA, but we do not believe it would be used for a Canadian Clearing Member given the alternative of a Resolution.

1.7 For the purposes of preparing our advice we have only reviewed the following documents (the "**Opinion Documents**"):

- the Rulebook;
- the Clearing Membership Agreement; and
- the Deed of Charge.

1.8 We have reviewed the Opinion Documents in connection with the instructions to counsel provided to us by email on April 11, 2016 (the "**Instructions**") and the Service Description (as defined in the original Instructions which we received on December 9, 2013).

1.9 Our advice is given in respect of the specific questions raised by you as set out in Sections 3 and 4. We have assumed that any matters which are or could be material in the context of the delivery of this opinion letter have been disclosed to us.

1.10 Our advice is given in respect of obligations (a) arising under contracts to which LCH is a party, which have been duly registered by LCH; (b) which are legal, valid, binding and enforceable; and (c) which are mutual between the Parties in the sense that each Party is personally and solely liable as regards obligations owing by it and is the sole and beneficial owner of obligations owed to it. Accordingly and without limitation, no opinion is expressed where a Canadian Clearing Member is acting as agent for another person, or is a trustee, or in respect of which a Canadian Clearing Member has a joint interest (including partnership) or, other than with respect to the Deed of Charge, in respect of which a Canadian Clearing Member's rights or obligations or any interest therein have been assigned, charged, attached, garnished or transferred (whether in whole or in part) whether unilaterally, by agreement or by operation of law.

1.11 This advice is given on the basis that LCH is not itself insolvent for the purposes of any insolvency law and is not subject to any insolvency proceeding in any jurisdiction.

1.12 This advice relates solely to matters of Ontario law and Canadian federal law (as in force at the date of this opinion) and does not consider the impact of any laws (including insolvency laws) other than the laws of this jurisdiction, even where, under the laws of this jurisdiction, any foreign law falls to be applied. This advice and the opinions given in it are governed by Ontario law and relate only to Ontario and Canadian federal law as applied by the Ontario courts or, where expressly stated, a duly constituted arbitral tribunal with its seat in Ontario as at today's date. We assume no duty to update this opinion letter or inform LCH or any other person to whom a copy of this opinion letter may be communicated of any change in the law of this jurisdiction (including, in particular, applicable case law), or the legal status of any party to the Services, or any other circumstance that occurs, or is disclosed to us, after the date on which this opinion letter is given, which might have an impact on the opinions given in this opinion letter. Several Canadian banks have their registered offices and/or principal offices in the Province of Quebec. **Quebec provincial law issues are dealt with in a separate opinion provided by our Montreal office dated July 31, 2018.**

1.13 We are not expressing any opinion as to any matters of fact.

1.14 We do not opine on the enforceability of any final sum certified as payable to LCH (as described at the end of our response in paragraph 3.13) and we do not express any view as to the enforceability of the Default Arrangements in relation to any action which LCH may seek to take outside this jurisdiction.

1.15 We have not been responsible for advising any party to the Opinion Documents other than LCH for the purposes of this opinion letter and the delivery of this opinion letter to any person other than LCH to whom a copy of this opinion letter may be communicated does not evidence the existence of any relationship of client and adviser between us and such person.

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

- any liability to tax as a result of or in connection with the Services, or the tax treatment of any Contract, the tax position of any party to the Opinion Documents or whether LCH is carrying on business in Canada in connection with the Services for tax purposes;
- any matters of fact or the reasonableness of any statements of opinion or intention expressed in relation to any Service, including any facts, events or circumstances arising as a result of the execution of any related documents by the Parties or the performance of the Parties' obligations deriving therefrom; and
- any prudential treatment of any Canadian Clearing Member's exposure to LCH (or any part thereof).

2. ASSUMPTIONS

We assume the following:

2.1 That each Party is duly incorporated and has the capacity, power and authority under all applicable laws to enter into the Opinion Documents and each Contract and to perform its obligations under the Opinion Documents and each Contract.

2.2 That each Party has taken all necessary steps to enter into, execute, deliver, be bound by and perform the Opinion Documents and each Contract, and that such steps have not been revoked or superseded.

2.3 That each Opinion Document and each Contract are legal, valid, binding and enforceable in accordance with its terms under the expressly chosen governing law.

2.4 That each Party has obtained, complied with the terms of and maintained all authorizations, approvals, licences and consents and has otherwise complied with all applicable laws and regulations required to enable it lawfully to enter into and perform its obligations under the Opinion Documents and the Contracts and to ensure the legality, validity, enforceability and admissibility in evidence of the Opinion Documents and each Contract in this jurisdiction.

2.5 That the Agreements are entered into by the Canadian Clearing Member prior to the formal commencement of any Insolvency Proceeding or Reorganization Measure in respect of that Canadian Clearing Member or any analogous proceeding commenced outside of this jurisdiction.

2.6 That each Party acts in accordance with the powers conferred by the Arrangements; and that (save in relation to any non-performance leading to the taking of action by LCH under the Default

Rules) each Party performs its obligations under the Arrangements, the Opinion Documents and each Contract in accordance with their respective terms.

2.7 That the Canadian Clearing Member is not a "bridge institution" as defined in the CDIC Act.

2.8 That the contractual arrangements and obligations established pursuant to and by the Arrangements, the Opinion Documents and each Contract are not capable of being avoided for any reason other than as mentioned in paragraphs 3.11 and below.

2.9 That, apart from any circulars, notifications and equivalent measures published by LCH in accordance with the Rulebook, there are not, and will not be, any other agreements, instruments or arrangements between the Parties which modify or supersede the terms of the Arrangements and/or any Opinion Document.

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

2.11 That none of the balances held in a Client Account opened by a Canadian Clearing Member with LCH in respect of one or more of its Clearing Clients will have the benefit of any client money protections provided for by any applicable law.

2.12 That the Canadian Clearing Members and LCH have properly executed the Agreements and that each Agreement is executed by the relevant parties to it in substantially the same form as the Agreements reviewed by us as described in paragraph 1.7 above and LCH's Rulebook (which is incorporated as part of the Clearing Membership Agreement).

2.13 All acts, conditions or things required to be fulfilled, performed or effected in connection with the Agreements under the laws of any jurisdiction other than this jurisdiction have been duly fulfilled, performed and effected.

2.14 Securities that LCH receives as Collateral and holds are recorded in fungible book-entry form in an account maintained by a financial intermediary (which could be a central securities depositary ("CSD") or a custodian, nominee or other form of financial intermediary, (in each case an "Intermediary") in the name of LCH. LCH's Intermediary may itself hold its interest in the relevant securities indirectly with another Intermediary or directly in certificated or uncertificated form, and that account with LCH's Intermediary is not located in Canada (the "relevant account").[2] LCH maintains accounts for each Clearing Member and such accounts are located in England on the basis that English law is the governing law of the Clearing Membership Agreement.

2.15 The provision of Collateral to LCH can be evidenced in writing or by electronic means and any other durable medium and that such evidencing permits the identification of the Collateral (provided that, for this purpose, it is sufficient to prove that the Collateral taking the form of book-entry securities has been credited to, or forms a credit in, the relevant account).

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[2] For Ontario law purposes an account would be located in a particular jurisdiction if the expressly stated "securities intermediary's jurisdiction" was that jurisdiction, or, in the absence of such designation, if the governing law of the account agreement was the law of that jurisdiction. See the body of this opinion for further detail on determining the "securities intermediary's jurisdiction".

2.16 Until such time as the security interest created by the Deed of Charge has been released, the Securities will be held by LCH in accordance with the terms of the Opinion Documents.

2.17 That LCH at all times exercises its rights under the Opinion Documents and does not waive any requirement for it to consent to the withdrawal of any Securities.

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

2.19 That the Security Deed would be interpreted under English law as creating an assignment of the Account Balance and Clearing Entitlement by the Canadian Clearing Member to the Client.

3. OPINIONS

On the basis of the foregoing terms of reference and assumptions and subject to the reservations set out in Section 5 and the qualifications set out in Section 6 below, we make the following statements of opinion.

Membership

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

There are no statutory limitations on the capacity of Canadian banks that would prevent them from entering into the LCH Agreements. The *Bank Act* is the constating document of a Canadian bank. It provides that a bank has the capacity of a natural person and, subject to any restrictions in the Bank Act, the rights, powers and privileges of a natural person (s.15(1)). There is nothing in the Bank Act that limits a bank's powers with respect to entering into interest rate swap transactions, foreign exchange transactions, repurchase agreements or clearing agreements. Banks are also specifically authorized to exercise their powers outside of Canada, subject to the laws of the relevant non-Canadian jurisdiction (s.15(4)). The Bank Act provides that no act of a bank is invalid by reason only that it is contrary to the bank's incorporating instrument or the Bank Act (s.16). Further, section 988 provides that unless otherwise expressly provided in the Bank Act, a contravention of any provision of the Act or the regulations does not invalidate any contract entered into in contravention of the provision.

By-laws of the bank may impose limitations on powers or require certain procedures to enter into agreements. However, the Bank Act provides that no bank may assert against a person dealing with the bank that the by-laws have not been complied with (s.20(1)(a)). There is an exception if the person has or ought to have knowledge of a limitation in the by-law by virtue of their relationship with the bank. There is no duty to review the by-laws.

A bank is required to have a policy regarding the creation of security interests that is approved by the board of directors and to which the bank must adhere. This again is an internal governance matter (s.419).

A person contracting with a Canadian bank may rely on the usual or ostensible authority of representatives of the bank (s.20(1)(d)).

There are at present no regulatory requirements that would prevent or limit a Canadian Clearing

Member from entering into the LCH Agreements.

3.2 ***Would LCH be deemed to be domiciled, resident or carrying on business in this jurisdiction by virtue of providing clearing services to a Canadian Clearing Member? If so, would LCH be required to obtain a licence or be registered before providing clearing services to a Canadian Clearing Member or are there any special local arrangements for the recognition of overseas clearing houses in these circumstances?***

There are a number of contexts in which it is relevant to know whether an entity is domiciled, resident or carrying on business in Canada. These include tax, extra-provincial registration statutes, various licensing statutes and, to the extent applicable, the carrying on business prohibition in the Bank Act. While each of these must be approached individually, it is generally not the case that the mere fact that a person, not otherwise resident in Canada or carrying on business here, enters into a contract with a resident of Canada constitutes the conduct of a business here, provided that the contract is entered into outside of Canada and the contract is performed by such person outside of Canada.

The *Securities Act* (Ontario) prohibits any person or company from carrying on business in Ontario as a clearing agency unless recognized by the Commission as a clearing agency (s.21.2). The Commission recognized LCH as a clearing agency on September 10, 2013.[3]

LCH's SwapClear system is designated by the Bank of Canada under section 4 of the PCSA. Designation under Part I (section 4) of the PCSA confers on both a designated system's operator and the Bank of Canada certain rights and responsibilities. Designation is available only with respect to clearing systems that are determined by the Bank of Canada to be systemically important in Canada. This determination may be made on the Bank of Canada's own initiative, without any request or consent of LCH. Designation provides LCH with respect to SwapClear only with certain protections under Canadian law, including with respect to netting, finality of payment and finality of settlement (albeit subject to certain restrictions under the CDIC Act). Designation also gives the Bank of Canada the responsibility to oversee SwapClear, with the primary objective of controlling systemic risk. It empowers the Governor-in-Council to issue directives to LCH and SwapClear's Canadian participants if it believes that systemic risk is being inadequately controlled. In practice, the Bank of Canada will exercise oversight through the FSA's Multilateral Arrangement for Regulatory, Supervisory and Oversight Cooperation on LCH's SwapClear OTC Interest Rate Clearing Service, of which the Bank of Canada is a member.

LCH could apply for designation from the Minister of Finance (Canada) under section 13.1 of the PCSA with respect to the Other Services. This would mean that LCH has the protections for its rules under section 13.1 in the event of insolvency of the Clearing Member. This protection is broader than the other available stay exemption laws that would apply to Other Services in that it covers all collateral types, is specific to enforcing the clearing house "rules".[4] LCH is not legally required to obtain this designation.

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[3] 36 O.S.C.B. 9268.

[4] With the amendments to the CDIC Act discussed below, LCH will have the protections afforded to a clearing house by virtue of the designation of SwapClear under section 4 of the PCSA even with respect to Other Services. Under the prior version of the CDIC Act, the protection extended only to SwapClear. Note, however, that there is no longer a full exemption of clearing houses from the stays under the CDIC Act. This subject is addressed below.

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

Capacity of the Canadian Clearing Member is established by the Bank Act.

Corporate authority should be established by providing evidence that the Agreements have been authorized by the board of directors, or properly authorized delegates. This could be established by the delivery of the relevant by-laws or board resolutions (or excerpts from them), and other delegations of authority if relevant, all as certified in an officer's certificate. An opinion from internal bank counsel might also be provided.

Authority of signatories should be established with an incumbency certificate certifying the offices and signatures of the persons executing the Agreements on behalf of the Canadian Clearing Member.

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

No. (The governing law of the Agreements will, as a matter of Ontario law, govern any contract law formalities.) There are no registration or stamp taxes that apply to the execution of documents.

3.5 ***Would the courts of this jurisdiction uphold the contractual choice of law and jurisdiction set out in Regulation 51?***

Choice of Law

Generally, a contractual choice of law will be recognized and applied by an Ontario court to contract law issues, such as contract formation, validity, interpretation and remedies. A choice of law is only ever relevant to issues that, under the laws of a province, are to be determined in accordance with the chosen law of the contract, meaning essentially foundational contract law. By foundational contract law, we mean the contractual matters that would be governed by the law of the contract such as contract law principles for formation of a contract (e.g. capacity (although the governing law may in turn look to domicile in that regard), offer, acceptance, consideration, duress, unconscionability and formalities for contracting) as well as principles of interpretation and breach of contract damages principles.

Consequently, with respect to matters of foundational contract law, in any proceeding in an Ontario Court for the enforcement of the Agreements, the Ontario Court would apply the chosen law, subject to the exceptions set out below.

There are certain situations in which an Ontario Court might not apply the parties' choice of law to contract law issues, which are set out in Section 5 of this opinion.

Submission to Jurisdiction

The submission to the jurisdiction of the English courts in Regulation 51 would be sufficient to confer jurisdiction on the English courts for purposes of recognizing and enforcing a judgment of the English courts and in that sense an Ontario court would recognize and give effect to the submission. An Ontario court has discretion to accept jurisdiction notwithstanding that the parties have agreed to submit, either exclusively or non-exclusively, to the courts of another jurisdiction.

However, where the submission is "exclusively" to the foreign courts, as in this case, a party seeking to commence the action in the Ontario court would have to demonstrate "strong cause"5 why the Ontario Court should accept jurisdiction in place of the contractually selected jurisdiction.

3.6 ***Will the courts of this jurisdiction uphold the judgment of the English courts or an English arbitration award?***

Judgments

In Ontario, an action can be commenced in a court of competent jurisdiction to recognize and enforce a judgment of a court in another jurisdiction. In addition, Ontario has enacted legislation to establish a more streamlined process to recognize and enforce judgments from the courts of certain other jurisdictions, including the U.K. This legislation provides for very similar requirements and defences to the common law which applies to enforcement by action. This opinion explains the requirements for enforcement by action in Ontario.

An Ontario Court would give a judgment based upon a final and conclusive *in personam* judgment of a court exercising jurisdiction obtained against the party with respect to a claim arising out of the Agreements without reconsideration of the merits, provided that certain requirements were met and subject to certain defences that may be available.

The requirements are the following:

- The judgment must be for a sum certain in money. If it is not, it may nevertheless be enforceable without a reconsideration of the merits. However, the law on this issue is in an early stage of development, so no certain opinion can be expressed with respect to non-money judgments. Non-money judgments must be considered on a case by case basis.
- The foreign court granting the judgment must have had jurisdiction over the parties and the cause of action. The contractual election of the party to the jurisdiction of the court is sufficient to confer jurisdiction for this purpose.
- An action to enforce the judgment must be commenced in the Ontario Court within any applicable limitation period in Ontario.
- The Ontario Court has discretion to stay or decline to hear an action on the judgment if it is under appeal or there is another subsisting judgment in any jurisdiction relating to the same cause of action.
- The *Currency Act* (Canada) requires judgements to be rendered only in Canadian dollars. The legislation governing the courts in Ontario contains mechanisms for the conversion of foreign currency amounts at the date of payment under the judgment. The *Courts of Justice Act* (Ontario) provides that an Ontario court in granting an order to enforce an obligation in a foreign currency is to convert the amount to the amount of Canadian currency sufficient to purchase the amount of the obligation in the foreign currency at a bank in Ontario listed in Schedule I to the Bank Act as at the close of business on the first day on which the bank quotes a Canadian dollar rate for purchase of the foreign currency before the day payment of the obligation is received by the creditor. The court can choose conversion as of a different date if this method of conversion would be inequitable to any party. If the judgment is executed upon, the relevant date for conversion is the

[5] Z.I. Pompey Industrie v. ECU-Line N.V 2003 SCC 27.

date when the bailiff or sheriff receives the money from the sale or garnishment. The parties to a contract can also provide for some different method of conversion and the court must then give effect to that method.

- An action in the Ontario Court on the judgment may be affected by bankruptcy, insolvency or other similar laws affecting the enforcement of creditors' rights generally.

A judgment debtor can also raise certain defences, which are the following:

- The judgment was obtained by fraud or in a manner contrary to the principles of natural justice.
- The underlying claim is based on a non-Canadian revenue, expropriatory, penal or other public law.
- The judgment is contrary to public policy.
- The judgment is contrary to an order made by the Attorney General of Canada under the *Foreign Extraterritorial Measures Act* (Canada) or by the Competition Tribunal under the *Competition Act* (Canada) in respect of certain judgments referred to in these statutes. These statutes are unlikely to apply to a judgment enforcing the Opinion Documents.
- The judgment has already been satisfied or is void or voidable under the law of the jurisdiction granting the judgment.

Arbitration Awards

Canadian law is very receptive to arbitration, including the enforcement of arbitral awards. As provided for in the *International Commercial Arbitration Act* (Ontario), an Ontario court of competent jurisdiction would enforce a binding commercial arbitral award granted by an arbitrator or panel of arbitrators pursuant to an arbitration conducted in a non-Canadian jurisdiction enforcing the rights of LCH against a Canadian Clearing Member under the Agreements if:

(a) It supplied the court with (1) a duly authenticated original award or certified copy of the award, (2) the original arbitration agreement or a duly certified copy of the arbitration agreement, (3) if the arbitration agreement is not in English, a duly certified translation of the agreement, and (4) if the award is not in English, a duly certified translation of the award,

(b) the award had not been set aside or suspended by a court of the country or state in which or under the law of which the award was made,

(c) The Canadian Clearing Member does not furnish proof to the court that:

(i) a party to the arbitration agreement was under some incapacity,

(ii) the arbitration agreement is invalid under the law of the non-Canadian jurisdiction,

(iii) it was not given proper notice of the appointment of an arbitrator or of the arbitral proceedings or was otherwise unable to present its case,

(iv) the award deals with a dispute not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration, provided that, if the decisions on matters submitted to arbitration can be separated from those not so submitted, that part of the award which contains decision

matters submitted to arbitration may be recognized and enforced, or

(v) the composition of the arbitral tribunal or the arbitral procedure was not in accordance with the agreement of the parties, or, failing such an agreement, was not in accordance with the law of the jurisdiction where the arbitration took place, and

(d) the court does not find that:

(i) the subject matter of the dispute is not capable of settlement by arbitration under Ontario law, or

(ii) the recognition or enforcement of the award would be contrary to the public policy of Ontario.

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

Public policy is a quite narrow concept in terms of the exception to the application of a chosen governing law or enforcement of a foreign judgment. It must at least violate some fundamental principle of justice, some prevalent conception of good morals or some deep-rooted tradition in the forum.

In bankruptcy proceedings, there may be policy considerations that prevent the enforcement of certain types of contracts. A contract that provides for the appropriation of assets of an insolvent entity for less than fair value may offend this bankruptcy policy.

An Ontario court will not enforce a judgment of a foreign court that is contrary to public policy. Again this is a narrow concept.

Insolvency, Security, Set-off and Netting

3.8 ***Please identify the different types of Insolvency Proceedings and Reorganization 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 of the Default Rules? Are any other events or procedures not envisaged in Rule 3 of the Default Rules relevant?***

The Insolvency Proceedings that could apply to a Canadian bank are a Winding-up under the WURA. The applicable Reorganization Measures are a vesting order, a receivership or a conversion order under the CDIC Act. The Canada Deposit Insurance Corporation ("**CDIC**") (the Canadian deposit insurer) controls the proceedings under the CDIC Act.

Winding-up Under WURA

Winding-up is commenced by court order appointing a liquidator. Many of the terms for the conduct of the liquidation are set out in the order and are, to an extent, at the discretion of the court. The WURA orders can provide for a number of stays and other limitations on the exercise of contractual rights against the insolvent party. A WURA proceeding with respect to a Canadian deposit taking institution would likely follow a CDIC proceeding once restructuring transactions have been attempted or, where assets are sold or transferred, with respect to the remaining insolvent institution for purposes of distributing the proceeds realized by CDIC in the course of the CDIC Act proceeding.

CDIC Act Proceedings

The Superintendent of Financial Institutions may take control of a federal deposit taking institution's assets. After taking control, the Superintendent might also, as a further step, take over the management of the business and affairs of the institution. This power is exercised on a temporary basis. The Superintendent is not given any extraordinary powers that could, in our view, allow him to alter the contractual or other arrangements of the financial institution. If that control fails to resolve the issues with the institution, the government may make certain orders putting CDIC in control of the institution.

The CDIC Act was amended as of June 22, 2016 and again as of December 19, 2017 to implement an enhanced resolution regime for domestically systemically important banks and to enhance the powers of CDIC to deal with insolvent federal deposit taking financial institutions ("**member institutions**"). The Governor in Council (essentially the federal Cabinet) on recommendation of the Minister of Finance can make certain orders under section 39.13(1) of the CDIC Act with respect to a financially distressed (or insolvent) member institutions in order to provide for the orderly resolution (a "**Resolution Order**"). The possible Resolution Orders are:

(a) vesting in CDIC the shares and subordinated debt of the federal member institution that are specified in the order;

(b) appointing CDIC as receiver;

(c) directing the Minister of Finance to incorporate a bridge institution; or

(d) with respect to a domestic systemically important bank ("**D-SIB**"), directing CDIC to carry out a conversion of its prescribed shares and liabilities to common shares in the case of domestic systemically important banks.[6]

The Resolution provisions are intended to implement the Financial Stability Board's Key Attributes of Resolution Regimes for Financial Institutions.

The bridge institution order must be made in conjunction with a receivership order. A bridge institution is an institution of the same type as the insolvent member institution (e.g. a bank in the case of the Canadian Clearing Members) incorporated by a Cabinet order. The shares of a bridge institution would be owned by CDIC. A bridge institution is not a Crown agent, but CDIC is obligated to provide the financial assistance that a bridge institution requires to discharge its obligations.[7] In addition, CDIC is empowered to enter into other transactions, including sales of assets.

Covered by Default Rule 5 Events

We believe that a WURA Winding-up (liquidation) and the making of a Resolution Order would constitute an event under Rule 5(m) and (j) respectively of the Default Rules. A vesting order

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[6] The conversion order can only be made if a receivership order it also made. The conversion order provisions are not yet in force, pending promulgation of the related regulations.

[7] S.39.3713. Except for obligations to CDIC itself. The bridge institution will lose its designation as such after 2 years, when CDIC is no longer the sole shareholder or if it is amalgamated with another entity that is not a bridge institution. The financial assistance obligation will end when the designation ends.

(with or without a conversion order) where CDIC[8] is not also appointed receiver, is not expressly covered by the events in Rule 5. However, in that circumstance if LCH concludes that the Clearing Member appears "to be unable, or to be likely to become unable, to meet its obligations in respect of one or more Contracts", the trigger for the exercise of the steps listed in Rule 6 would apply.

3.9 ***Would the Deed of Charge be effective in the context of Insolvency Proceedings or Reorganization Measures in respect of a Canadian 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 Canadian Clearing Member under the Deed of Charge?***

Effectiveness of Deed of Charge in Context of Insolvency Proceedings or Reorganization Measures

Pursuant to the Deed of Charge, the Canadian Clearing Member agrees to grant, with full title guarantee, in favour of LCH a first fixed security over certain specified Securities. The Securities are rendered subject to the charge by submission of the appropriate details, as provided at Section 4 of the LCH Procedures, by the Canadian Clearing Member to LCH, and by the delivery of securities matching the description to a designated securities account maintained in the name of LCH.

In order to be effective, in the context of an Insolvency Proceeding, Reorganization Measure or otherwise, LCH must have a valid and properly perfected first priority security interest in the Collateral.

The Deed of Charge would be characterized as a "security agreement" for Ontario personal property security law purposes. Ontario law is largely indifferent to the form of security agreement used. Any security interest that secures payment or performance of an obligation, including a charge or an absolute assignment, is subject to the Ontario *Personal Property Security Act* ("**PPSA**").

Conflict of Laws Issues

In considering the steps necessary to create and protect the security interest, the first inquiry is to what extent Ontario law would govern these issues. As we understand it, the collateral subject to the Deed of Charge would be Securities delivered to LCH by or on behalf of the Canadian Clearing Member and held in an LCH account at a securities depository. Cash distributions and proceeds of the Securities are transferred to a Cash Account at LCH itself.

The PPSA sets out specific conflict of laws rules for validity, perfection and priority of security interests in "investment property". Investment property includes "security entitlements". The term "security entitlements" is defined in the *Securities Transfer Act* (Ontario) ("**STA**") . Security entitlements are basically rights with respect to securities and other financial assets (including credit balances) held by securities intermediaries in securities accounts. Securities and other financial assets held by LCH in accounts with an Intermediary are investment property. Consequently, under the PPSA validity, perfection and priority are governed by the law of the

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[8] CDIC would not meet the definition of a Regulatory Body as defined in the LCH Rules.

securities intermediary's jurisdiction at the time of creation (in the case of validity) or at the time the issue is being determined (in the case of perfection and priority) (PPSA, s.7.1).

The securities intermediary's jurisdiction is determined in accordance with the rules set out in the STA. Those rules specify a number of alternatives for determining the securities intermediary's jurisdiction applied in the following order:

(i) the jurisdiction specified as the securities intermediary's jurisdiction for the purpose of Ontario law, the STA or any provision of the STA in the securities account agreement between the intermediary and its entitlement holder (e.g. the agreement between LCH and its depository with respect to the account in which LCH holds the securities);

(ii) the expressly stated governing law of the securities account agreement;

(iii) if the securities account agreement expressly provides that the securities account is maintained at an office in a particular jurisdiction, then that jurisdiction;

(iv) the jurisdiction in which the office identified in an account statement as the office serving the entitlement holder's account is located; or

(v) the jurisdiction where the chief executive office of the securities intermediary is located.[9]

For securities entitlements held in an Intermediary outside of Ontario (whether securities or cash that may be credited to a securities account), Ontario law would not govern validity, perfection or priority of the security interest in investment property.

LCH is itself a "securities intermediary" since it is designated by the Bank of Canada under section 4 of the PCSA and recognized as a clearing agency by the Commission. We believe that the Cash Accounts would also be characterized as securities accounts for purposes of the STA and PPSA given LCH's status as a securities intermediary. We believe the intention of designating recognized clearing agencies to be securities intermediaries is to ensure that any clearing accounts benefit from the provisions even though the clearing agency is not acting in the capacity of a securities intermediary as that term would normally be understood. Credit balances in a securities account are treated as financial assets for purposes of the STA. This issue is explained in more detail in answer to question 3.2.3 with respect to rights of set-off against cash cover.

Substantive contract law matters relating to security agreements are determined by the governing law of the security agreement (PPSA, s.8). Substantive issues involved in the enforcement of the rights of a secured party against collateral are similarly governed by the proper law of the contract. Consequently, English law will largely govern the interpretation of the Deed of Charge and its enforcement.

Procedural issues involved in the enforcement of the rights of a secured party are governed by the law of the jurisdiction in which the rights are exercised. For Collateral held directly by LCH or

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[9] The following factors are not to be taken into account in determining the securities intermediary's jurisdiction: (i) the physical location of certificates representing the financial assets; (ii) the jurisdiction in which the issuer of the financial asset is incorporated or otherwise organized; and (iii) the location of facilities for data processing or other record keeping concerning the securities account.

in depository accounts outside of Ontario subject to the Deed of Charge, it is unlikely that enforcement rights would be exercised in Canada.

Validity and Perfection if Ontario Law Governs

If LCH does hold Securities in accounts with Intermediaries in Ontario, then the security interest created by the Deed of Charge would be valid under Ontario law. No particular form of agreement or wording is required as long as the intention to create a security interest is clear and the Canadian Clearing Member has rights in the Collateral. LCH would be perfected under the PPSA by "control" by virtue of the securities entitlements being credited to its account. (Ontario law is modelled on and is very similar to Uniform Commercial Code Revised Article 8 and Article 9 in terms of security interests in indirectly held securities). Further, by virtue of LCH's status as the securities intermediary it would have automatic control on that basis with respect to any financial assets maintained in accounts of the Canadian Clearing Member at LCH.[10]

Procedures in Enforcing Rights against Collateral

As noted above, because enforcement action is not likely to be taken in Ontario, any procedural requirements of the PPSA will not apply, as procedural matters will be governed by the laws of the place where such actions are taken. Substantive matters with respect to enforcement are determined by English law as the governing law of the Deed of Charge.

Stays on Enforcing Rights under Deed of Charge

PCSA Protections – Part I Designation as Systemically Important Clearing System

Because the SwapClear clearing system is designated by the Bank of Canada under Part I, section 4 of the PCSA, section 8 of the PCSA provides certain protections to SwapClear settlement rules that apply "[n]otwithstanding anything in any statute or other law of Canada or a province". These include rights to deal with collateral in accordance with default rules. In more detail, the protections include:

> (a) that the "settlement rules" are "valid and are binding on the ... participants" and any action may be taken or payment made in accordance with the settlement rules;
>
> ...
>
> (d) the rights and remedies of a participant, a clearing house, or a central counter-party in respect of collateral granted to it as security for a payment or the performance of an obligation incurred in a designated clearing and settlement system may not be the subject of any stay provision or order affecting the ability of creditors to exercise rights and remedies with respect to the collateral.

"Settlement rules" means:

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[10] As additional comfort, the first paragraph of Section 7 of the STA states "A rule adopted by a clearing agency governing rights and obligations between the clearing agency and its participants or between participants in the clearing agency is effective even if the rule conflicts with this Act or the Personal Property Security Act and affects another person who does not consent to the rule." This section applies to LCH since it has been recognized by the OSC as a clearing house under the Ontario Securities Act or Quebec Derivatives Act.

> the rules, **however established**, that provide the basis on which payment obligations, delivery obligations or other transfers of property or interests in, or in Quebec rights to, property are made, calculated, netted or settled and includes **rules for the taking of action in the event that a participant is unable or likely to become unable to meet its obligations to the clearing house, a central counter-party, other participants or the Bank.** [emphasis added]

These protections are, however, subject to the CDIC Act Resolution Order overrides, which are addressed below.

The combination of the relatively wide definition of settlement rules and the validation of action taken pursuant to the settlement rules should protect the default processes generally of SwapClear with respect to the Deed of Charge, assuming that the security interest of LCH is properly perfected under the applicable governing law. These protections do not apply to the Other Services.

With respect to the Other Services, LCH would rely on the specific stay exemptions in the WURA and CDIC Act (described in the following paragraphs) that apply to exercising remedies for default in performance, termination, netting and dealing with financial collateral.

PCSA – Designated Clearing Houses and Collateral Dealing Protections

In addition to the protection for the settlement rules of a clearing and settlement system designated under section 4 of the PCSA as systemically important systems (which are discussed above with respect to SwapClear), the PCSA has two sets of provisions of interest. First it has safe harbours for termination, netting and enforcing collateral rights for eligible financial contracts (close out netting and collateral protections) that parallel those in the CDIC Act, where the agreement is between financial institutions (or between a clearing member and its customer). Since LCH is not likely a "financial institution" for purposes of this definition this stay exemption is not likely to apply. Second, section 13.1 grants protection from insolvency law and proceeding stays to certain designated clearing houses to allow enforcement of their clearing rules relating to settlement, close-out and collateral enforcement. LCH is not designated under section 13.1, but we have included information on this as LCH could seek to obtain this designation.

The Clearing House Protection – s.13.1

PCSA section 13.1 includes express protection for enforceability in insolvency of clearing house rules relating to termination, netting and collateral enforcement in the context of insolvency proceedings or laws (foreign or Canadian).

This provision is also subject to the CDIC Act resolution overrides discussed below that apply where an order under Resolution.

A derivatives and securities clearing house is defined to include any entity designated by the Minister of Finance under s.13.1(2). The Minister can designate an entity if it is in the public interest to do so and the entity provides clearing services to its members for securities or derivatives. LCH could apply for such a designation in order to obtain the express benefit of this provision with respect to the Other Services. While it overlaps the CDIC EFC Stay Exemption (addressed and defined below) to some extent, it is not framed in exactly the same terms. First, it protects the "rules" of the clearing house (not just the terms of agreements) as they apply to the calculation of payment and delivery obligations. Second, it states more generally that insolvency orders and laws cannot interfere with rights or remedies in respect of collateral granted to the

clearing house to secure obligations to it of the clearing member (and it does not require the collateral to be financial collateral).[11]

CDIC Act

General Stay on Termination and Creditor Remedies

Where a Resolution Order is made there is an automatic *prima facie* stay under section 39.15(1) (**"General Stay"**) on various actions, including termination or acceleration of obligations under agreements, set-off and realization of collateral, where those rights arise by virtue of certain resolution related triggers. With particular relevance to collateral enforcement, it provides that no creditor has any remedy against the institution or its assets. It also provides that no person may terminate or amend any agreement with the institution or claim an accelerated payment by reason only of certain events (**"termination stay"**). Since termination or acceleration of outstanding contracts and consequently the coming into existence of the secured obligation is a precondition to collateral enforcement of security for that obligation, this stay could also affect rights to deal with collateral pursuant to the Deed of Charge to the extent it applies to the amounts owing on close-out. It further provides that any stipulation in an agreement that provides otherwise with respect to the termination right is of no force and effect. The resolution related events upon which a creditor is not permitted to rely in order to terminate are (paraphrased):

(a) insolvency or deteriorated financial condition of the FI or any of affiliates or its credit support providers (**"Insolvency"**);

(b) a pre-proceeding non-monetary default by the FI or affiliates (**"pre-Order non-monetary default"**);

(c) a pre-proceeding monetary default by the FI or affiliates that is remedied within 60 days of the order being made (**"pre-Order monetary default"**);

(d) the making of the Order or any change of control related to the making of the Order (**"making the Resolution Order"**);

(e) the assignment or assumption of the agreement to or by a bridge institution or third party (**"Transfer of contract"**);

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[11] 13.1 (1) Nothing in any law relating to bankruptcy or insolvency or in any order of a court made in respect of the administration of a reorganization, arrangement or receivership involving insolvency, including in any foreign law or order of a foreign court, has the effect of

(a) preventing a securities and derivatives clearing house from

(i) if it is a party to a netting agreement, terminating the agreement and determining a net termination value or net settlement amount in accordance with the provisions of the agreement, with the party entitled to the value or amount becoming a creditor of the party owing the value or amount for that value or amount, or

(ii) acting in accordance with any of its rules that provide the basis on which payment and delivery obligations are calculated, netted and settled; or

(b) interfering with the rights or remedies of a securities and derivatives clearing house in respect of any collateral that has been granted to it as security for the performance of any obligation incurred in respect of the clearing and settlement services provided by the securities and derivatives clearing house. [our emphasis]

(f) the transfer to a third party (under the resolution process)[12] of all or part of the assets or liabilities of the federal FI institution or any of its affiliates ("**Transfer of assets**"); or

(g) a conversion order under the CDIC Act or a conversion under the terms of the FI's shares or liabilities[13] ("**Conversion**").

Further, s.39.15(2.1) provides that any stipulation in the rules of an organization (which would include the LCH Rules) is of no effect if it has the effect of providing for or permitting termination based on the above events or if it provides that the institution ceases to have the rights of a member, including the right to use or deal with assets that it would otherwise have on the above events.

Clearing House Exemption from General Stay

The CDIC Act confers a specific, but qualified, exemption[14] from the General Stay for certain clearing houses ("**Clearing House General Stay Exemption**"). It provides that none of the stays provided for in subsections 39.15(1) to (2.1) apply so as to prevent a "clearing house":

(a) from ceasing to act in that capacity for a federal member institution; or

(b) from exercising its rights under its settlement rules, as defined in subsection 8(5) of the PCSA.

A "clearing house" means (a) a clearing house, as defined in section 2 of the PCSA, that provides clearing and settlement services for a clearing and settlement system designated under section 4 of that Act, or (b) a securities and derivatives clearing house, as defined in subsection 13.1(3) of the PCSA. LCH is a clearing house based on its section 4 designation. Therefore, subject to the further limitations described below, LCH is not prevented by the General Stay from exercising its rights under its settlement rules. As noted above in the discussion of the PCSA, settlement rules are defined widely in subsection 8(5). Note that the definition of settlement rules itself is not specific to the rules associated with the designated clearing and settlement system and that s.39.15(3.2) is not restricted to settlement rules related to the designated system.[15] Consequently, unlike the prior version of the CDIC Act, actions taken with respect to collateral under the settlement rules, including the default rules, of LCH are not restricted to SwapClear, but should also apply to Other Services. Rights under the Deed of Charge that support the default process should also be covered by the Clearing House General Stay Exemption.

Limitations on the Clearing House General Stay Exemption

However, there is a further exception to reliance on subsection s.39.12(3.2). The clearing house must continue to act as clearing house for the institution and the General Stay does apply if CDIC has given an undertaking to provide the financial assistance that the member institution needs in

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[12] i.e. the third party transfer process allowed for by the CDIC Act and its regulations.

[13] These liabilities would not include liabilities to LCH. It's the debt obligations that have conversion features and which are treated as a form of capital for the FI.

[14] s.39.15(3.2)).

[15] Unlike the situation under the PCSA itself, which restricts its safe-harbours to the rules of the designated system.

order to discharge its obligations to the clearing house as they become due (the "**financial assistance undertaking**").[16] CDIC would likely make this financial assistance undertaking if it believed that the financial institution could be returned to solvency, the clearing relationship could be transferred to a bridge institution or the clearing relationship could be transferred to a third party to whom all or substantially all of the assets of the member institution could be transferred.

If the financial assistance undertaking is not given, then LCH would be free to exercise the rights it has under its settlement rules pursuant to the Clearing House General Stay Exemption with respect to SwapClear or the Other Services.

EFC Exemption from the General Stay (s.39.15(7))

In addition to the Clearing House General Stay Exemption, any party to an "eligible financial contract", including a clearing house, may rely on s.39.15(7) (the "**EFC General Stay Exemption**") to exempt it from the General Stay. Eligible financial contracts include derivatives agreements and repurchase agreements.[17] (See Appendix A for the full definition). An interest rate swap is a derivatives agreement. A currency swap or foreign currency forward or option or equity or credit derivatives are also derivatives agreements. A clearing agreement with respect to derivatives is also an eligible financial contract. Consequently, the Canadian Member Clearing Agreement, being an agreement to clear derivatives agreements (and a master agreement with respect to derivatives agreements) is also an eligible financial contract. With respect to the RepoClear service it is an agreement to clear securities or is itself a repurchase agreement and is, consequently, an eligible financial contract with respect to the RepoClear service as well. An eligible financial contract also includes an agreement relating to "financial collateral", including any form of security or security interest in collateral and a title transfer credit support agreement, with respect to another eligible financial contract. Therefore, the Deed of Charge is also an eligible financial contract.

Subject to the Resolution Order overrides described below, the General Stay does not prevent the following actions being taken in accordance with the provisions of the eligible financial contract,[18] namely:

- **Termination** - the termination or amendment of the contract[19]
- **Acceleration** - the accelerated payment or forfeiture of the term under the contract[20]
- **Remedies for payment default** - the exercise of remedies for a failure to satisfy an obligation under or in connection with the contract, including payment or delivery obligations[21]

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[16] s.39.15(3.3).

[17] Each of the WURA and *CDIC Act* provides that an "eligible financial contract" is defined by the regulations to the Act. (The PCSA adopts the WURA definition). The regulation to each of the Acts is identical in terms of the definition. The definition is framed in general terms and includes a wide range of non-exclusive underlying interests (defined non-exclusively).

[18] s.39.15(7).

[19] CDIC Act, s.39.15(7)(a).

[20] CDIC Act, s.39.15(7)(b).

[21] CDIC Act, s.39.15(7)(c).

- **Netting** - the netting or setting off or compensation of an amount payable under or in connection with the contract[22]
- **Collateral Dealing** - any dealing with financial collateral to satisfy a payment or delivery obligation, for the purpose of calculating an amount payable under or in connection with the contract by way of netting or set off or compensation of the proceeds or value of the financial collateral or as a remedy for a performance failure[23]
- **Close-out Collateral Dealings** – any other dealings with financial collateral[24]

However, the EFC Exemption is qualified by certain prohibitions addressed in sections 39.15(7.101) to (7.105) (the "**Resolution Override**"). The Resolution Override prevents a counterparty from relying on certain resolution related events as events of default or termination events to trigger certain close-out rights. This Resolution Override does not prevent the exercise of termination or acceleration rights based on a performance default (including payment or delivery defaults) either before or after the making of the Resolution Order and the member institution is required to continue to perform during the resolution process.[25] Other than the suspension of the right to rely on the resolution events to the extent they are events that would have triggered the contractual right to terminate[26], there is no interference with the General Stay Exemption.

Where a Resolution Order is made, termination, acceleration and close-out collateral dealing (as described in the list above) cannot be taken by reason only of certain resolution related events, namely Insolvency, Transfer of assets, Transfer of contract, making the Resolution Order, or Conversion[27]. However, the prohibition on reliance on Insolvency is time limited unless certain events occur. Further, as explained in more detail below, the non-defaulting Party will have a right to rely on the making of the Resolution Order in certain circumstances.

Right to Rely on Insolvency or Deteriorated Financial Condition

The prohibition on relying on Insolvency[28] ceases to apply to an eligible financial contract at the end of the initial stay period (5:00 p.m. (Ottawa time) on the second business day[29] after the day on which the Resolution Order is made), unless CDIC has committed before the end of the initial stay period to assign the contract to a bridge institution.[30]

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[22] CDIC Act, s.39.15(7)(d).

[23] CDIC Act, s.39.15(7)(e).

[24] CDIC Act, s.39.15(7)(f).

[25] As is the counterparty by virtue of the prohibition on relying on the resolution events to "amend" the contract.

[26] And certain collateral dealing rights. Not all resolution measures would necessarily be events of default under the relevant Agreement.

[27] See definitions above.

[28] Which includes insolvency or deteriorated financial condition of the party, its credit support providers or its affiliates.

[29] A business day is a day other than Saturday, Sunday or a holiday in the jurisdiction where the head office of the institution is located.

[30] CDIC Act, s.39.15(7.102).

The prohibition on relying on Insolvency may end earlier if CDIC considers that all or substantially all of the member's assets will be transferred to a third party[31] and that the eligible financial contracts of the Party with the member will not be assigned to the third party. In that case CDIC can so notify the parties and the prohibition on relying on Insolvency will end as of the time of the notice.[32] This notice could be provided before the end of the initial stay period.[33] The prohibition continues, however, if the eligible financial contracts are transferred to a third party during the initial stay period.

In order to rely on Insolvency that state of insolvency (or deteriorated financial condition) must exist at the time the prohibition ceases to apply.[34] So for example, if resolution actions are taken before or during the initial stay period that restore financial stability (such as conversion or bail-in), a non-defaulting Party cannot rely on the fact that the institution was insolvent at the date the Resolution Order was made. The CDIC Act does provide that these prohibitions on relying on the other Resolution Events do not prevent a person from relying on the facts that led to the making of the Resolution Order as evidence of insolvency or deteriorated financial condition.[35]

Right to Rely on the Making of the Order

In certain cases the prohibition on relying on the making of the Resolution Order itself as an event of default or termination event will cease. If the Resolution Order directs the incorporation of a bridge institution, then like the prohibition on relying on Insolvency, the prohibition on relying on the Resolution Order ceases to apply to an eligible financial contract at the end of the initial stay period, unless CDIC has committed before the end of the initial stay period to assign the contract to a bridge institution.[36]

As with the right to rely on Insolvency, the prohibition on reliance on the Resolution Order will also cease if CDIC considers that all or substantially all of the institution's assets will be transferred to a third party[37] and that the eligible financial contracts of the party with the institution will not be assigned to the third party. In that case CDIC may so notify the parties (before or after the initial stay period) and the prohibition will cease as of the time of the notice.[38] If it occurs after the end of the initial stay period it may provide a more objectively determined Event of Default than reliance on Insolvency provides.

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[31] Pursuant to the provisions of the act allowing transfers to third parties that meet specified criteria intended to insure their creditworthiness.

[32] CDIC Act, s.39.15(7.101). Although the Act says "a third party", because words in a statute are understood to include the plural, this could involve transfers to more than one third party as long as in aggregate all or substantially all of the assets were to be transferred.

[33] Although it is irrelevant if after because that prohibition has already ceased by virtue of section 39.15(7.102) and it is clear that (7.101) does not preclude reliance on (7.102). See CDIC Act, 39.15(7.103) which for greater certainty provides for the prohibition to cease at the earlier of the time under (7.101) and (7.102).

[34] CDIC Act, s.39.15(7.104).

[35] CDIC Act, s.39.15(7.105).

[36] CDIC Act, s.39.15(7.102).

[37] Pursuant to the provisions of the Act allowing transfers to third parties that meet specified criteria intended to insure their creditworthiness.

[38] CDIC Act, s.39.15(7.101).

If any of the eligible financial contracts are assigned to or assumed by a bridge institution or third party, then all transactions subject to the same master agreement must be assigned and assumed together with any related security.[39] In other words, no cherry-picking of transactions is permitted on a forced transfer. Once the transactions are transferred to the bridge institution or third party, the prohibition on relying on the resolution related events becomes permanent.[40]

If the eligible financial contracts with a particular party are not transferred[41] or the restructuring fails, and a winding-up order under the WURA is made with respect to the non-viable member institution, that winding-up order could be relied on by LCH as a fresh default.[42] In that case the analysis in this opinion with respect to a WURA Proceeding would apply.

Once CDIC considers that all possible transactions have been carried out under its restructuring powers, it can publish a notice to that effect and, on the effective date of that notice, the General Stay also ceases to apply. However, in this case, unless a winding-up order under the WURA has also been made, the prohibitions on relying on the Resolution related events continue to the extent that they relate to the prior events of default.[43] The intention here is that if the institution is restructured and is continuing in business, then contracting parties should not be entitled to exercise their remedies unless they arise from a fresh or continuing default.

Summary

Based on the above, it is our opinion that the exercise of rights under the Deed of Charge will continue to be enforceable in the context of a process commenced by the CDIC Act Resolution Order. In coming to this conclusion, we rely on the following:

1. If CDIC does not give LCH a financial assistance undertaking, there are no stays applicable to exercising rights under the Deed of Charge in the context of a CDIC Act proceeding, through reliance on exemptions from the General Stay and Resolution Override applicable to a "clearing house" or reliance on the EFC General Exemption.
2. If CDIC does give LCH a financial assistance undertaking:
    a. LCH would continue to be able to rely on the General Stay Exemption with respect to any events of default other than the Resolution Events, including a performance related Event of Default or the commencement of formal insolvency proceedings under the WURA in the event the Resolution fails or the Canadian Clearing Member's Clearing Membership Agreement and Contracts are not transferred to a bridge institution or third party in the course of the Resolution.
    b. The Resolution Override is time limited as it applies to Insolvency as a trigger event.
    c. The Resolution Override is potentially temporary, such as where the Contracts are not transferred to a bridge institution or credit worthy third party.

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[39] CDIC Act, s.39.15(7.3).

[40] CDIC Act, s.39.152(1).

[41] Which may be the case, for example, if they are out of the money for the institution.

[42] CDIC Act, s.39.18(1) provides that section 39.15 cease to apply on the date that a winding-up order is made in respect of the institution.

[43] CDIC Act, s.39.18(2).

d. No cherry picking of Contracts is permitted on a forced transfer to a bridge institution or third party.

e. Netting is not stayed (except to the extent the Resolution Override prevents termination or acceleration based on certain resolution events as described above affects netting).

f. The Canadian Clearing Member would be required to continue to perform its obligations notwithstanding the making of the Resolution Order or the taking of any steps pursuant to it.

If, however, the Clearing Membership Agreement and all Contracts are transferred to a solvent third party or bridge institution, the default is essentially cured by the transfer and the Resolution Override will remain in effect.

WURA Winding-up

Under the WURA there is express recognition of the right to terminate, to net close out values and to deal with financial collateral for an eligible financial contract ("**WURA EFC Stay Exemption**").[44] The express protection applies to any "dealing" or right to "deal with" "financial collateral" in the manner provided for in the agreement between the parties. To "deal with" includes (a) selling or foreclosing financial collateral; and (b) setting off financial collateral or applying the proceeds or value of financial collateral.

"Financial collateral" is defined in the WURA as:

> "financial collateral" means any of the following that is subject to an interest ... that secures payment or performance of an obligation in respect of an eligible financial contract or that is subject to a title transfer credit support agreement:
>
> (a) cash or cash equivalents, including negotiable instruments and demand deposits,
>
> (b) securities, a securities account, a securities entitlement or a right to acquire securities, or
>
> (c) a futures agreement or a futures account;

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[44] 22.1 (1) Nothing in this Act or an order made under this Act prevents or prohibits the following actions from being taken in accordance with the provisions of an eligible financial contract:

(a) the termination of the contract;

(b) the netting or setting off or compensation of obligations between a company in respect of which winding-up proceedings under this Act are commenced and another party to the contract; and

(c) any dealing with financial collateral including

(i) the sale or foreclosure or, in the Province of Quebec, the surrender of financial collateral, and

(ii) the setting off or compensation of financial collateral or the application of the proceeds or value of financial collateral.

(1.01) If the net termination values determined in accordance with the eligible financial contract referred to in subsection (1) are owed by the company to another party to the eligible financial contract, that other party is deemed to be a creditor of the company with a claim provable against the company in respect of the net termination values. [emphasis added]

"Securities", "securities account" and "securities entitlement" are not defined, but in our view would at least include any publicly traded debt or equity securities. The Collateral subject to the Deed of Charge is financial collateral and it is "subject to an interest ... that secures payment or performance of an obligation in respect of an eligible financial contract".

Consequently, the WURA EFC Stay Exemption would apply to the enforcement of rights by LCH under the Deed of Charge. If, however, a parallel or previous CDIC Act Proceeding occurs in which a stay is in place, then the WURA EFC Stay Exemption cannot be relied on to the extent inconsistent with those stays. Section 39.18(1) of the CDIC Act provides that section 39.15 ceases to apply on the date that a winding-up order under the WURA is made with respect to the financial institution, but that is subject to the continuation of these stays if the Contracts have been transferred to a bridge institution or third party in the course of the Resolution.

3.10 ***Would LCH have the right to take the actions provided for in the Default Rules (including exercising rights to deal with Contracts under Rule 6 and rights of set-off under Rule 8 but not at this stage considering those actions specifically provided for in the Client Clearing Annex to the Default Rules) in the event that a Canadian Clearing Member was subject to Insolvency Proceedings or Reorganization Measures? Is it necessary or recommended that LCH should specify that certain Insolvency Proceedings and/or Reorganization Measures will constitute an Automatic Early Termination Event in accordance with Rule 3 of the Default Rules? If the answer is affirmative, which specific Insolvency Proceedings and/or Reorganization Measures does this answer apply to and what is the reasoning?***

Rule 6 of the Default Rules allows LCH to take various actions including transferring open Contracts, closing out open Contracts by transferring open contracts of another Clearing Member to the Defaulting Clearing Member's account, terminating open Contracts, selling any security deposited by the Clearing Member, and entering into hedging contracts for the account of the Defaulting Clearing Member. Pursuant to Rule 8, LCH has the right to determine any net amounts payable between the Defaulting Clearing Member and LCH in respect of each kind of account and included in the netting calculation is any cash Collateral balance of the Defaulting Clearing Member in its relevant kind of house/proprietary accounts.

Is it Necessary to Apply the Automatic Early Termination Event?

It is not necessary that any Insolvency Proceeding or Reorganization Measure constitute an Automatic Early Termination Event in accordance with Rule 3 of the Default Rules in order for the section 8 protections with respect to SwapClear[45] to apply, or the CDIC Act Stay Exemption to apply to the right to deal with Contracts under Rule 6 and rights of set-off under Rule 8 of the Default Rules. The WURA EFC Stay Exemption and the CDIC EFC Stay Exemption apply to rights taken under elective provisions. In those cases where there is no stay exemption or the right to rely on it is suspended, it would not improve LCH's position materially to designate the event as an Automatic Early Termination Event. Similarly, LCH would not avoid the limits on relying on those exemptions (the Bridge Institution Stay and the Restructuring Stay) by having an Automatic Early Termination Event.

Set-off and Stays

The effectiveness of the right to set-off a cash collateral balance (Cash Cover as defined in the Clearing Membership Agreement) or the proceeds of sale of collateral is subject to the analysis in

[45] Only SwapClear is designated so these protections do not apply to the other services.

our response to question 3.9 above with respect to dealings with financial collateral. The WURA EFC Stay Exemption and the CDIC EFC Stay Exemption, which might otherwise apply to the exercise of rights with respect to collateral, are discussed in the answer to that question include the right to set-off a cash collateral balance unless it is in the normal course of settling transactions. So too are any right to take realization actions against collateral such as a right to sell or otherwise dispose of collateral (unless in the normal course of settling transactions). Consequently, the CDIC EFC Stay Exemption and the WURA EFC Stay Exemption apply, subject to the Resolution Override, where applicable.

Protecting Rights with respect to Cash Cover

The right to set-off Cash Cover (as defined in the Clearing Membership Agreement), is also potentially subject to the application of personal property security laws. As far as Ontario law is concerned, even an absolute transfer of cash and right of set-off with an obligation to return equivalent cash might be characterized as a security interest in the cash if its purpose is to provide credit support. The Cash Cover may be deemed to be the collateral in which LCH has a security interest (in other words, a charge back even if not so described). If LCH does not have a first priority security interest in the cash (or right of set-off that is effective against secured creditors of the Canadian Clearing Member) a competing secured creditor (if any) could require payment in priority to the application of the amounts credited to the Canadian Clearing Member's accounts. There are a number of bases upon which LCH could nevertheless be entitled to exercise its rights of set-off in the face of claims by competing secured creditors:

- We believe that Cash Cover credited to the Canadian Clearing Member's LCH account is a financial asset in a securities accounts, as LCH would meet the Ontario law definition of a "securities intermediary" given its designation under section 4 of the PCSA and its recognition by the Commission as a clearing agency. The Cash Cover balances should be characterized as financial assets credited to a securities account and, consequently, English law should apply to validity, perfection and priority of any security interest. Consequently, Ontario law should not govern validity, perfection or priority of the "deemed" security interest LCH has in the credit balances in the accounts at LCH as the securities intermediary's jurisdiction for LCH is presumably England and not Ontario.[46] If LCH's rights are protected under English law, an Ontario court should recognize those rights.

- Also, even if the cash balances are not characterized as "securities accounts" and Ontario law does apply, the normal priority rules of the PPSA with respect to cash collateral[47] arguably would not apply to LCH. Section 7(1) of the STA provides that a rule adopted by a recognized clearing agency governing rights and obligations between the clearing agency and its participants or between participants is effective even if the rule conflicts with the STA or the PPSA and even if it affects a third party who did not consent to the rule. The Clearing Membership Agreement (s.2.16) provides that any purported charge, assignment or encumbrance of Cash Cover provided to LCH is void. This provision provides the basis for the position that LCH's set-off right is superior and effectively has priority. However, there is ambiguity as to the meaning of this provision as

[46] The perfection method for such property where Ontario law governs is by "control" and the securities intermediary would by definition have control.

[47] Which as noted in our prior memorandum would require perfection by registration and priority based on order of registration as against consensual secured creditors.

it is not clear that "rights and obligations" of the Canadian Clearing Member includes priority rules in the PPSA.

- LCH does not necessarily have to rely on a perfected security interest in order to exercise set-off rights notwithstanding the interest of any competing secured creditor. Section 40 of the PPSA provides that an account debtor (LCH in this case) may set up by way of defence against an assignee of the account debt all defences available to the account debtor against the assignor arising out of the terms of the contract giving rise to the debt or a related contract.[48] This should permit LCH to set up any of its set-off rights and any of the other terms and conditions of the LCH Rulebook or Clearing Membership Agreement relating to the cash margin against any third party to whom the account debt has been assigned (whether a competing secured creditor or not).[49] It is also arguable that it is English law (and not section 40) that applies to the effectiveness of the right of set-off (in general and as against a person with a security interest in the receivable) given that English law is the governing law of the receivable. Again, this is not clear under Ontario law.

We note that the PPSA provides that a contractual prohibition on assignment of an account is not enforceable against a third party who has taken an assignment of or a security interest in the account.[50] This does not detract, however, from the principles noted in the paragraph above as any such assignee or secured party would take subject to contract defences.

There is some uncertainty as to whether all or any of the above arguments would prevail. For that reason we recommend taking steps to perfect the potential deemed security interest under Ontario law. For PPSA purposes, cash transferred absolutely to a secured creditor for purpose of securing an obligation if characterized as a security interest is characterized as an "intangible". The conflict of laws rule with respect to cash in this form applies the law of the place where the debtor is located. The method of determining "location" under the Ontario PPSA has recently changed. A federally incorporated corporation, such as each of the Canadian Clearing Members, is now located in the jurisdiction of its registered or head office as set out in its constating documents. Ontario law will therefore apply to entities with their registered or head offices in Ontario. Under Ontario law, perfection with respect to intangibles is by means of the registration of a financing statement under the PPSA register.[51] Priority based on registration of financing statements is governed by the order of registration.

Prior to January 2, 2016, entities with more than one place of business were located where the chief executive office was located. Certain of the Canadian Clearing Members that were "located" in Ontario,[52] are now located in other provinces.[53] There are detailed transitional rules

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[48] It is not clear that the PPSA, including this provision, would apply to English accounts. Section 40 is in large part a codification of common law so we assume English law recognizes a similar principle.

[49] We say "should" because the relationship between set-off rights and the priority rules in the PPSA has not been judicially considered so there is some uncertainty as to these matters. The most certain position for LCH is to rely on the PCSA designation and, in addition to its rights of set-off and flawed asset analysis, rely on its position as a clearing agency as described above.

[50] s.40(4).

[51] With respect to Bank of Nova Scotia, LCH should file a financing statement in Nova Scotia. With respect to Bank of Montreal and Royal Bank of Canada Quebec law will apply. As set out in the Quebec opinion, no registration is required in Quebec.

[52] Please note that a number of banks with chief executive offices in Ontario have their head office/

under the Ontario PPSA. The former method of determining location (chief executive office) will apply with respect to determining the law relevant to validity of the security interest for any security interest that arises under a "prior security agreement".[54] A prior security agreement is defined as an agreement entered into prior to December 31, 2015.

Amending, renewing or extending the security agreement does not change its status as a prior security agreement.

The general rule for perfection is that the new method will apply even with respect to a prior security agreement. However, for any prior security agreement (i.e. a Deed of Charge entered into before December 31, 2015) the transitional rule allows continued reliance on perfection under the prior law for a period of five years. The security interest arising under a prior security agreement is deemed to be perfected if perfected under the prior law until the earlier of the date it ceases to be perfected (e.g. the registration expires) or December 31, 2020. Ontario law further provides that if the secured creditor does take steps to perfect under the law of the new location, it will be continuously perfected from the date of the original perfection under the prior law. As far as Ontario law is concerned, LCH has until December 31, 2020 to perfect in accordance with the law of any new jurisdiction.

Because other jurisdictions in Canada still apply a chief executive office test, it would be prudent to consider validity of the security interest in both the jurisdiction of the chief executive office and registered office if they are in different places (e.g. Bank of Montreal, Royal Bank of Canada, Bank of Nova Scotia[55]).

PCSA Protections – Part I Designation of SwapClear as Systemically Important Clearing System

As noted above in question 3.2.3, LCH with respect to SwapClear may rely on section 8 of the PCSA. The combination of the relatively wide definition of settlement rules and the validation of action taken pursuant to the settlement rules should protect the default processes generally of SwapClear. The text of section 8 is as follows:

> 8. (1) Notwithstanding anything in any statute or other law of Canada or a province,
>
> (a) the settlement rules of a designated clearing and settlement system are valid and are binding on the clearing house, the participants, a central counter-party and the Bank and any action may be taken or payment made in accordance with the settlement rules;
>
> (b) the obligation of a participant, a clearing house or a central counter-party to make payment to a participant and the right of a participant, a clearing house or a central counter-party to receive payment from a participant, a clearing house or a central counter-party shall be netted and a net settlement or close-out amount shall be determined in accordance with the settlement rules, if they so provide; and

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registered office in other provinces. For example, the registered office of Royal Bank of Canada is in Quebec.

[53] Bank of Nova Scotia is located in Nova Scotia. Bank of Montreal and Royal Bank of Canada are "located" in Quebec.

[54] Ontario PPSA, s.7.2(5).

[55] See Appendix C.

(c) if a payment is made, property is delivered or an interest in, or in Quebec a right to, property is transferred in accordance with the settlement rules of a designated clearing and settlement system, the payment, delivery or transfer shall not be required to be reversed, repaid or set aside.

(2) An entry to or a payment out of the account of a participant, a clearing house or a central counter-party at the Bank to settle a payment obligation in a designated clearing and settlement system shall not be the subject of any provision or order that operates as a stay of that activity.

(3) The rights and remedies of a participant, a clearing house, a central counter-party or the Bank in respect of collateral granted to it as security for a payment or the performance of an obligation incurred in a designated clearing and settlement system may not be the subject of any stay provision or order affecting the ability of creditors to exercise rights and remedies with respect to the collateral.

(3.1) Despite subsections (1) to (3) and the settlement rules:

(a) no action may be taken in respect of an eligible financial contract, as defined in subsection 39.15(9) of the *Canada Deposit Insurance Corporation Act*, if it is prevented by subsection 39.15(7.1), (7.104), (7.11), (7.12) or (7.2) or section 39.152 of that Act; and

(b) a clearing house, as defined in subsection 39.15(9) of the *Canada Deposit Insurance Corporation Act,* shall comply with subsection 39.15(3.3) of that Act[56], shall take any action required by subsection 39.15(7.12)[57] of that Act and shall not take any action prevented by that subsection 39.15(7.12)[58].

(4) Notwithstanding that all or part of the administration or operation of a designated clearing and settlement system is conducted outside Canada or that its settlement rules are governed by the laws of a foreign jurisdiction, where in any judicial proceedings in Canada a court determines that the rights and obligations of any person arising out of or in connection with the operation of the designated clearing and settlement system are governed in whole or in part by Canadian law, the provisions of this section shall be applied to the extent that the Canadian law applies in determining those rights and obligations.

(5) In this section, "settlement rules" means the rules, however established, that provide the basis on which payment obligations, delivery obligations or other transfers of property or interests in, or in Quebec rights to, property are made, calculated, netted or settled and includes rules for the taking of action in the event that a participant is unable or likely to become unable to meet its obligations to the clearing house, a central counter-party, other participants or the Bank.

These protections in the context of SwapClear are also limited by the CDIC Act Resolution Override described above in our response to question 3.2.2.

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[56] The requirement to continue to act as clearing house for the member institution if CDIC has given the financial undertaking to provide the necessary financial assistance to the institution.

[57] The action required is that required by the General Stay if the financial assistance undertaking is given.

[58] The action stayed by the General Stay if the financial assistance undertaking is given.

WURA and CDIC Act Stays and Stay Exemptions

With respect to rights to terminate, net transaction exposures and deal with financial collateral with respect to the Other Services, the analysis set out above in our response to questions 3.2.2. will apply. LCH could rely on the WURA EFC Stay Exemption and, except where subject to the Resolution Override, the CDIC EFC Stay Exemption in the case of a Resolution Order. Other rights (such as the right to transfer open Contracts (without terminating) or enter into hedging Contracts for the account of the Defaulting Clearing Member) are not protected by these stay exemptions.

The analysis set out above in our response to question 3.2.2 specifically addressed LCH's right to deal with financial collateral in the context of Insolvency Proceedings and Resolution. This same analysis applies to a right to terminate or accelerate Contracts and, consequently, to net transaction exposures.[59] That analysis also could apply to SwapClear, but given the designation under section 4 of the PCSA and the wider protection section 8 consequently provides, it is not necessary to rely on the express stay exemptions.

Possible Stays

Where a Resolution Order is made (a vesting order, receivership order or conversion order) there is an automatic *prima facie* stay under section 39.15(1) (**General Stay**) on various actions, including termination or acceleration of obligations under agreements, set-off and realization of collateral, where those rights arise by virtue of certain triggers.

A court order made in the context of a Winding-up under the WURA could include similar prohibitions to the termination stay and dealing with assets stay. Generally rights of set-off, including contractual set-off, are recognized in a Winding-up.[60]

Entering into hedging arrangements in order to mitigate losses or gains on Contracts is not specifically stayed. The right to transfer open contracts may be viewed as a dealing with the assets of the insolvent member.

The WURA EFC Stay Exemption and the CDIC Act Stay Exemption each confer specific protection for acceleration or termination and close out netting rights under an "eligible financial contract" and so would override the termination stay, the dealing with assets stay (to the extent it applies to dealings with collateral although not the transfer of open contracts) and the set-off stay. This conclusion is subject to the Resolution Override that applies in a Resolution as described above in our response to question 3.2.2.

3.11 ***Is there a "suspect period" prior to Insolvency Proceedings and/or Reorganization Measures where Contracts with a Canadian Clearing Member could be avoided or challenged and, if so, what are the grounds? What are the risks for LCH in entering into Contracts and in taking Collateral in respect of those Contracts during such a period? Are any special protections or exemptions from the relevant arrangements for avoidance or***

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[59] The Resolution Override does not limit a right to net or set-off, but to the extent that right is only effective if transactions are terminated, they are effectively stayed. Netting or dealing with collateral that arises in the usual course of business is not prevented.

[60] WURA, s.73.

challenge available under the law of the Relevant Jurisdiction in respect of contracts in financial markets?

There are statutory preference laws that could apply to preferential transactions or collateral transfers.

WURA

The WURA contains two sets of provisions with potential application to a transfer of collateral or potentially a transaction that is not on market terms which is intended to prefer a creditor. These are:

(a) the unjust preference provisions, and

(b) the payments within 30 days of winding-up provision.

Unjust Preferences

Section 100 of the WURA voids any deposit, transfer or payment to a creditor "in contemplation of insolvency" that has the effect of giving the creditor an "unjust preference". Normally, any deposit, transfer or payment made within 30 days of the appointment of the liquidator is deemed to have been made in contemplation of insolvency. A recent amendment, however, provides that this presumption does not apply to a sale, deposit, pledge or transfer of "financial collateral" made in accordance with the provisions of an "eligible financial contract." The intention of this provision is to clarify that collateral provided on a mark to market basis (such as variation margin) in periods close to insolvency is not suspect. By virtue of this provision, the liquidator would have to prove the transfer of collateral was made with the intention to provide the secured party an unjust preference. It is not just transfers and transactions that take place within the suspect period (i.e. three months) that are subject to being set aside though; any transaction if the liquidator proves it was made with the requisite intent and effect can be set aside.

The meaning of the term "unjust" in this context is unclear. However, there is some early case law suggesting that it means only that the transfer or payment interferes with the rateable distribution of the insolvent company's assets. The meaning of the phrase "in contemplation of insolvency" is also unclear. It likely means that the transfer or payment is made at a time when the transferor is either insolvent or very nearly insolvent with the intention of giving the creditor a preferred position over other creditors. Any transfers or payments made within 30 days of the commencement of liquidation would be deemed to be made with this intent (unless they were transfers or payments with respect to financial collateral for an eligible financial contract).

A challenging party would have to bring forth evidence to generally meet the liquidator's case with respect to the bank's intent. It will always be essential to demonstrate that in making any transfer at a time when it is insolvent, the Clearing Member had a reasonable and bona fide belief that by doing so it would be able to carry on in business and the fact that a failure to deliver margin is an event of default entitling LCH to terminate all transactions will be of assistance in this regard. The preferential intent might be disproved by evidence that the transfer was made pursuant to an obligation that pre-dated insolvency and the suspect period.

Because SwapClear is designated under section 4 of the PCSA, these provisions of the WURA should not apply to ordinary course transfers of collateral in the SwapClear system. As noted above section 8 of the PCSA provides that:

- the "settlement rules" are "valid and are binding on the ... participants" and any action may be taken or payment made in accordance with the settlement rules;

- if a payment is made, property is delivered or an interest in property is transferred in accordance with the settlement rules of such a designated system, that payment, delivery or transfer is final.

Payments within 30 Days of Winding-up

Payments made within 30 days of the commencement of liquidation can be set aside. Subsection 101(1) voids every "payment" made within 30 days of commencement of the liquidation by an insolvent company to a person who knows of the insolvency or who has reason to know of it. Intent in making the payment is not relevant under this provision. If, during this 30-day period, a contracting party had actual knowledge of the bank's insolvent state or reason to question its solvency, then payments under contracts made during this period might be set aside.

This provision does not apply, however, to a payment made in connection with financial collateral in accordance with the provisions of an eligible financial contract. In other words, collateral transfers would not be subject to this provision.

Provincial Legislation

There is provincial preferences legislation that is similar to the WURA preferences provisions (the *Assignments and Preferences Act* (Ontario)). For various procedural reasons it is rarely relied on by insolvency representatives or other creditors. It would be unlikely, again for practical reasons, to be relied on with respect to a Canadian Clearing Member. Also, because SwapClear is designated under section 4 of the PCSA, the provisions with respect to finality of transfers should apply to override these provisions in the case of SwapClear.

3.12 ***Is there relevant netting legislation in this jurisdiction that, in the context of Insolvency Proceedings or Reorganization Measures in respect of a Canadian Clearing Member, might apply as an alternative to the relevant arrangements set out in the Default Rules?***

No there is not. Protections for netting must be founded in the contractual relationship between the parties or the rules of the clearing agency as described in the responses to the previous questions.

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

No. Claims must be made in Canadian dollars. There are no specific statutory rules that apply to conversion with respect to a Resolution under the CDIC Act or Winding-up under the WURA. However, the insolvency representative will require claims to be converted, likely as of the date of commencement of the proceeding at a published rate selected by the insolvency representative.

Client Clearing

3.14 ***Is there any law, regulation or statutory provision (having the force of law) in this jurisdiction which (if so designated by LCH) would be expected to qualify as an Exempting Client Clearing Rule? Would the relevant Rule would be expected to apply to Canadian Clearing Members of all entity types or to only certain entity types?***

Since we are dealing only with Canadian banks as Clearing Members, we have not addressed the question relating to different entity types.

We consider that section 8 of the PCSA as it applies to the SwapClear Service is an Exempting Client Clearing Rule. These protections include the enforceability of the "settlement rules" of the designated system notwithstanding any insolvency law to the contrary. The term "settlement rules" includes the default rules of the designated system.

This conclusion is subject to two qualifications:

- The Resolution Override addressed in our response to question 3.2.2 above override section 8 of the PCSA.

- It may still be necessary to enter into the Security Deed (as explained in more detail in our response to question 3.15). Consequently, we have addressed question 3.21 and 3.22 with respect to SwapClear.

3.15 ***If LCH were to: (i) declare a Canadian Clearing Member to be in Default in circumstances other than the commencement of Insolvency Proceedings or Reorganization 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 Canadian Clearing Member or any other person successfully challenge the actions of LCH and claim for the amount of the Account Balance?***

SwapClear

Section 8(1) of the PCSA provides certain protections to the settlement rules of designated systems "[n]otwithstanding anything in any statute or other law of Canada or a province", including providing (1) that the settlement rules are valid and binding on participants and validating any action taken in accordance with settlement rules, (2) for the finality of any transfers of any interest in property in accordance with the settlement rules, and (3) that a stay provision or order cannot affect the rights and remedies of the clearing house in respect of collateral granted to it as security for payment or performance of any obligations.[61] Settlement rules includes rules for the taking of action in the event that a participant is unable or likely to become unable to meet its obligations to the clearing house.

The combination of the relatively wide definition of settlement rules and the validation of action taken pursuant to the settlement rules should protect the default processes generally of the designated SwapClear system unless an order is made under s.39.13(1) of the CDIC Act and CDIC provides the financial assistance undertaking with respect to the obligations of the defaulting Canadian Clearing Member.[62]

The section 8 protections should include the transfer of Client Contracts on the basis that this is an action taken in the event that a participant is unable or likely to become unable to meet its obligations to the clearing house and the right to make the payment of the Account Balance directly to the Back-up Clearing Member (via the assignment to the Client and direction from the

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[61] (3) is not directly apt since porting is not a realization action with respect to LCH's security interest.

[62] Reliance on insolvency or the making of the order to trigger close-out rights is not permitted, but performance defaults can be relied on. See more detail in the response to question 3.2.2 above.

Client). We note, however, that there is no relevant case law considering the meaning and effect of section 8 of the PCSA and we cannot guarantee that it would validate every action taken in the porting process. In particular it may not go so far as to validate a transfer of the Account Balance to the Back-up Clearing Member where the right to that payment is founded solely on the rules and not on a legal, equitable or security assignment of that amount the priority of which is established under applicable law. Effectiveness may depend on the Canadian Clearing Member assigning the Account Balance to the Client (pursuant to the Security Deed or otherwise). For that reason we recommend the use of the Security Deed even though there is an Exempting Clearing Client Rule.

Other Services

The Other Services are not designated systems under section 4 of the PCSA.

Assuming no Insolvency Proceedings or Reorganization Measures have commenced and assuming that no other person has an assignment of or security interest in the Account Balance that has priority over the Client's interest under the Security Deed, the Canadian Clearing Member or other person could not challenge the actions of LCH and claim for the amount of the Account Balance from LCH.

See our response in paragraphs 3.21 and 3.22 with respect to the validity and perfection of the security interest in the Account Balance under the Security Deed.

3.16 ***If LCH were to: (i) declare a Canadian Clearing Member to be in Default in circumstances other than the commencement of Insolvency Proceedings or Reorganization 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 Canadian Clearing Member or any other person successfully challenge the actions of LCH and claim for the amount of the Client Clearing Entitlement?***

Please see our response in paragraph 3.15 above. The analysis would apply equally to the actions taken by LCH with respect to declaring a Default, terminating the Client Contracts, realizing on Collateral and determining the Client Clearing Entitlement.

If the Client has a first priority perfected security interest in the Client Clearing Entitlement and the Client has exercised its right to terminate the Client Transactions and realize on the Client Clearing Entitlement as security for any amount owing, then LCH could return the Client Clearing Entitlement to the relevant Clearing Client.

See our response in paragraphs 3.21 and 3.22 with respect to the validity and perfection of the security interest in the Client Clearing Entitlement under the Security Deed.

3.17 ***If (i) following the commencement of Insolvency Proceedings, a Canadian Clearing Member was designated a Defaulter (whether due to the delivery of a Default Notice or (if applicable) the occurrence of an Automatic Early Termination Event); and (ii) LCH were to seek to seek to port the Client Contracts and Account Balance of a Clearing Client to a Backup Clearing Member as a result, could an insolvency officer appointed to the Defaulter or any other person successfully challenge the actions of LCH and claim for the amount of the Account Balance?***

SwapClear

Subject to the following qualification, our response in paragraph 3.15 above with respect to SwapClear applies also in the context of an Insolvency Proceeding with respect to any actions by LCH.

To the extent the effectiveness of the process depends upon the exercise of rights of the Clearing Client against the Canadian Clearing Member, the effectiveness of porting will depend on the Clearing Client being in a position to exercise its rights against the Canadian Clearing Member. The Client is not directly covered by section 8 of the PCSA as it protects the rights of the clearing house and participants. Whether Clearing Clients may exercise their rights against the Canadian Clearing Member is examined below.

Other Services

Whether an Insolvency Proceeding could prevent LCH from porting and transferring the Account Balance depends on (1) the absence of statutory rules or court orders in the context of the proceedings that could interfere with the transfer of open positions under the Client Contracts pursuant to the rules of the LCH, and (2) LCH's ability to transfer the Account Balance to the Backup Clearing Member (which in turn depends on the Client's ability to terminate the Client Transactions subject to the Client Clearing Agreement and realize on its security interest over the Account Balance under the Security Deed).

Stays in Insolvency Proceedings

The first question is whether there are any statutory or potential court ordered stays under the WURA that could prevent LCH with respect to Client Contracts or the Client with respect to the Client Transactions from declaring the default based on the insolvency or commencement of the proceeding and either terminating the transactions with the Canadian Clearing Member, realizing on the margin posted by the Canadian Clearing Member or transferring the Client Contracts and Account Balance to the Backup Clearing Member.

Effect of PCSA

General EFC Stay exemption

The PCSA eligible financial contracts stay exemption (s.13) is intended to ensure that close-out netting rights in netting agreements between financial institutions are effective "despite anything in any law relating to bankruptcy or insolvency or any order of a court made in respect of a reorganization, arrangement or receivership involving insolvency". The stay exemption allows a party to terminate and net transaction values pursuant to the terms of an the eligible financial contract. The CDIC Act Resolution Override described above overrides this protection.[63]

The definition of netting agreement includes an eligible financial contract between a "participant"[64] and a "customer to which the participant provides clearing services". Consequently, it would include a Client Transaction between an Canadian Clearing Member and the Clearing Client even if the Clearing Client was not a financial institution and provide an additional basis for the exercise by the Clearing Client of its right to close-out the Client Transactions and direct the payment or

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[63] PCSA, s.13(1.2).

[64] Which included a member of a clearing house (PCSA, s.2).

transfer of the Account Balance to the Back-up Clearing Member outside of the context of a CDIC Act proceeding.

WURA Stay Exemption

The WURA Stay Exemption addressed in our response to question 3.2.2. applies in favour of both LCH with respect to the Client Contracts and the clients in respect of the Client Transactions. Consequently, in the context of an Insolvency Proceeding there are no applicable stays.

3.18 ***If (i) following the commencement of Insolvency Proceedings, a Canadian 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?***

Whether a Winding-up order under the WURA could prevent LCH from porting pursuant to the termination and rebooking method depends on (1) the absence of statutory rules or court orders in the context of the proceedings that could interfere with termination of the Client Contracts pursuant to the rules of the LCH or the Cleared Client Transactions pursuant to the terms of the Client Clearing Agreement, (2) LCH's ability to realize on its Collateral for the Client Contracts and (3) LCH's ability to pay the Client Clearing Entitlement to the relevant Clearing Client (which depends on the ability to realize on the Client's security interest over the Client Clearing Entitlement under the Security Deed).

As to (1) and (2), LCH's ability to terminate the Client Contracts and realize on Collateral is the same analysis as applies to direct clearing as set out in paragraph 3.10 above.

As to (1), our response to the issue of termination by the Client is the same as in paragraph 3.17.

As to (3), our response to the issue of payment of the Client Clearing Entitlement directly to the Client is also the same as in paragraph 3.17 with respect to the Account Balance.

3.19 ***If (i) following the implementation of Reorganization Measures, a Canadian Clearing Member was designated a Defaulter (whether due to the delivery of a Default Notice or (if applicable) the occurrence of an Automatic Early Termination Event); and (ii) LCH were to seek to seek to port the Client Contracts and Account Balance of a Clearing Client to a Backup Clearing Member as a result, could the representative appointed to reorganise/manage the Defaulter or any other person successfully challenge the actions of LCH and claim for the amount of the Account Balance?***

CDIC Act Proceedings

Prima Facie Stays

The CDIC Act Resolution Override addressed above in our response to question 3.2.2 and 3.2.3 apply so as to prevent reliance on the Insolvency or the making of the Resolution Order as a ground for termination, exercise of set-off rights, or taking action against assets of the Canadian Clearing Member whether by LCH or the Client. These stays are described in paragraph 3.10

above.

Under the porting procedure, even though the Client Contracts are not closed out, the effect of porting is to terminate the Canadian Clearing Member's role in this Contract and, therefore, terminate it with the Canadian Clearing Member. Whether the termination stay applies to this situation where the Client Contract itself is not closed out is unclear. The dealing with assets stay applies more directly. The economic transfer method arguably transfers to the Backup Clearing Member an asset that the Canadian Clearing Member otherwise has a right to (namely the rights under Client Contract and the Account Balances) and in that sense removes from the Canadian Clearing Member its rights as principal with respect to those assets. The fact that the Canadian Clearing Member agreed to this process is not relevant to the application of the stay. It may be that a court would consider the overall structure of the clearing arrangements and determine that the Canadian Clearing Member has no real economic interest in the Client Contracts which it is clearing for Clients. However, given the principal to principal structure, it is not clear that it would make that determination.

Resolution Override

The Resolution Override described above in paragraph 3.10 would apply to the Client's right to terminate the Client Clearing Agreement and transactions subject to it and to realize on its charge over the Account Balance. There is in the case of the Client, no condition that CDIC give a financial assistance undertaking to the Client with respect to the institution's obligations in order for the Resolution Override to be effective.

There exists the possibility that LCH would be permitted to close-out the Client Contracts in circumstances where the Client would not be permitted to close-out the related Client Transaction (e.g. CDIC does not give the financial assistance undertaking). It would be reasonable to take the position that the exemption from the stay that applies to LCH in that case must necessarily also permit termination of the Client Transactions and realization of financial collateral by or on behalf of Clearing Clients in SwapClear since the stay exemption for LCH would be relatively meaningless with respect to client clearing if the Client Transactions are not also closed out. There should not be any policy reason to treat a principal based model differently than an agency clearing model. However, because the wording of the exemption does not make it clear that a client's related Cleared Transactions can also be terminated where the Client Contracts are, there is some question as to whether this symmetry of treatment would be assured. However, the practical reality is that given the nature of the relationships it would make little sense for the Client Contracts to be transferred without also transferring the Client Transactions. This would affect the right to transfer to the Account Balance to the Backup Clearing Member.

The stay is a permanent stay (except with respect to a fresh default) once the contracts have been assigned to a bridge institution or third party.

If there is an assignment to a bridge institution, all EFCs with a particular Client must be assigned to the bridge institution and all are guaranteed pursuant to this provision. To the extent the LCH rules can be characterized as a clearing contract with the Canadian Clearing Member, then the obligations under the rules would also be assigned. The purpose of the bridge institution provisions is to transfer the good assets and business to the bridge institution so that it can continue its business and be sold. In light of that purpose, it is likely the entire relationship including adherence to the LCH rules would be transferred.[65] It is unlikely that there would be an

[65] It may be necessarily to establish in advance a protocol with CDIC to deal with potential issues.

attempt to transfer the Client Contracts without taking into account the entire clearing relationship with LCH and consequently also transferring the Client Cleared Transactions. The same should be true of transfer to a third party.

We note that these CDIC Act provisions have not been applied in practice.

The PCSA's General Stay Exemption does not override Resolution Override.

3.20 ***If (i) following the commencement of Reorganization Measures, a Canadian 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?***

Whether a Resolution Order could prevent LCH from porting pursuant to the termination and rebooking method depends on (1) the absence of statutory rules or court orders in the context of the proceedings that could interfere with termination of the Client Contracts pursuant to the rules of the LCH or the Cleared Client Transactions pursuant to the terms of the Client Clearing Agreement, (2) LCH's ability to realize on its Collateral for the Client Contracts and (3) LCH's ability to pay the Client Clearing Entitlement to the relevant Clearing Client (which depends on the ability to realize on the Client's security interest over the Client Clearing Entitlement under the Security Deed).

As to (1) and (2), LCH's ability to terminate the Client Contracts and realize on Collateral is the same analysis as applies to direct clearing under Resolution as set out in paragraph 3.10 above.

As to (1), our response to the issue of termination by the Client is the same analysis as applies to direct clearing under Resolution as set out in paragraph 3.17.

As to (3), our response to the issue of payment of the Client Clearing Entitlement directly to the Client is also the same as in paragraph 3.17 with respect to the Account Balance.

3.21 ***Would the Security Deed provide an effective security interest under the laws of Ontario over the Account Balance or Client Clearing Entitlement in favour of the relevant Clearing Client?***

The Account Balance and the Client Clearing Entitlement would each be characterized as an "intangible" under the Ontario PPSA (as would the Client Contracts charged in favour of the Client). Consequently, validity of the security interest will be a matter for the law of the Canadian Clearing Member's location at the time of attachment of the security interest.

The charging language in the Security Deed is as follows:

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

For those Canadian Clearing Members located in Ontario (registered office in Ontario), this language will be sufficient to create a valid security interest in favour of each Client. As we note above, the stay exemptions with respect to the Client dealing with financial collateral treat an

"assignment" of an amount owing by the clearing house as financial collateral. We are assuming that the charge under English law constitutes an assignment of the Relevant Client Clearing Return and the Relevant Account Property.

3.22 ***Are there any perfection steps which would need to be taken under the laws of this jurisdiction in order for the Security Deed to be effective?***

Because the Account Balance and the Client Clearing Entitlement would be characterized as an "intangible" under the Ontario PPSA, perfection of the security interest and effect of perfection will also be governed by the laws of the Clearing Member's location. Perfection requires the filing of a financing statement by the Clients or a security trustee on behalf of Clients in the Ontario PPSA register where the Clearing Member is located in Ontario.[66]

Priority of security interests vis-à-vis other consensual secured creditors is governed by the order of registration of the financing statements.

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

There is such a risk. In a CDIC Act Resolution, the Resolution Override will apply so as to potentially delay enforcement by the Client of its rights under the Security Deed with respect to the Account Balance or Clearing Entitlement. In the context of a WURA proceeding (Insolvency Proceeding), the WURA EFC Stay exemption will apply (unless the transactions have been transferred to a bridge institution or third party as part of an earlier or concurrent restructuring process).

The PCSA Stay Exemption will also apply in favour of the Client in an Insolvency Proceeding.

3.24 ***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 Canadian Clearing Member of Client Clearing Services and which are not covered by the Questions above.***

There are no other significant legal issues for LCH in our view.

Client rights will be subject to establishing priority of the charge under Ontario law with respect to Account Balances and Client Clearing Entitlements over other competing consensual secured creditors, if any, and potential statutory non-consensual liens, charges and deemed trusts.

4. SETTLEMENT FINALITY

4.1 ***Would the commencement of Insolvency Proceedings in respect of a Canadian Clearing Member affect finality of settlement of transfers of funds or securities (or both) from the Canadian 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.***

SwapClear

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[66] With respect to Clearing Members located in other PPSA jurisdictions it will also be necessary to file a financing statement in those jurisdictions.

With respect to SwapClear Services, section 8 of the PCSA provides that:

- the "settlement rules" are "valid and are binding on the ... participants" and any action may be taken or payment made in accordance with the settlement rules; and

- if a payment is made, property is delivered or an interest in, or in Quebec a right to, property is transferred in accordance with the settlement rules of a designated clearing and settlement system, the payment, delivery or transfer shall not be required to be reversed, repaid or set aside.

The commencement of an Insolvency Proceeding does not in itself affect the operation of section 8. Payment and transfers made by the insolvent Canadian Clearing Member after commencement of Resolution or an Insolvency Proceeding would continue to benefit from this provision.

If the payment, delivery or transfer was made in breach of the Resolution Override, then that may provide a basis for reversing the particular payment or delivery.

As we noted above in answer to question 3.11, Section 8 of the PCSA should also override any federal preference or fraudulent conveyance laws that may affect pre and post proceeding transfers of property. It is not as clear that it overrides provincial ones, but provincial proceedings under the Ontario statutes are rarely brought and are unlikely to be commenced with respect to a federal financial institution.

Other Services

Section 8 of the PCSA does not apply to payments, deliveries or transfers in connection with the settlement rules for the Other Services. Consequently it is necessary to consider the potential application of the preference avoidance provisions of the WURA and applicable provincial legislation. To the extent the transfers are transfers of financial collateral, the preference issues are addressed above in question 3.11.

Section 100 of the WURA applies to transfers of property by the company made in contemplation of insolvency that prefer a creditor and could apply to payments or transfers by the Canadian Clearing Member after commencement of a CDIC Act proceeding or a WURA proceeding. There is a presumption where any payment or transfer is made that has the effect of preferring a creditor, that a preference was intended if the transfer was made within 30 days or commencement of the winding-up or after commencement of the WURA proceeding. The presumption can be rebutted. Transfers or payments that occur as part of the settlement process that do not involve an action on the part of the Canadian Clearing Member would not likely be caught by this provision on the basis that they are not payments or transfers by the Canadian Clearing Member. Further payments to secured creditors that reduce or discharge a secured debt should not generally be considered to be a preference or to prejudice other creditors, so long as (i) the payment does not exceed the value of the collateral, (2) the security interest is properly perfected and it is first ranking and (3) if it does not, in some other manner, prejudice other secured creditors. Secured creditors are treated as a separate class in an insolvency proceeding (or fall outside the proceeding entirely) and the effect of the payment to them will free up corresponding value in the security (potentially) which will be available to meet claims of other creditors. The other creditors are not prejudiced by the payment.

If transfers or payments are made by the Canadian Clearing Member after the appointment of CDIC as receiver or appointment of a liquidator under the WURA, then it is likely that they would

be made with the consent of CDIC or the liquidator in order to not default and hence keep the clearing relationship in place. With respect to post-proceeding payments or transfers, it should be kept in mind that any performance failure that would result from not making a payment or transfer due after commencement of a proceeding can be relied to trigger remedies because the automatic stay only prevents reliance on certain termination triggers and with respect to defaults, only pre-proceeding defaults. Also, while intent is a factual matter to be determined at the time of the transfer, normal course payments and deliveries made with the intent to keep the clearing relationship in place would not likely be found to have been made with a preferential intent, especially where CDIC is involved.[67] The case law supports that the "dominant intent" must be to prefer the creditor if the transfer is to be set aside as preferential.[68]

This same analysis with respect to intent would apply the provincial proceedings under the *Assignments and Preferences Act*.

Section 101(1) of the WURA voids every payment made within thirty days before the commencement of a WURA proceeding by a company unable to meet its engagements in full, to a person who knows of that inability or has probable cause for believing that inability exists. The amount paid may be recovered back by the liquidator by suit or action in any court of competent jurisdiction. This provision does not apply to payments made after commencement of the WURA proceeding. As with section 100, it requires the payments to be made by the company, so it should not apply to settlements occurring pursuant to the settlement processes through the actions of LCH.

While payments made during a Resolution and prior to commencement of a WURA proceeding may be made by the Canadian Clearing Member they would be made at a time when CDIC is in control of the institution. CDIC has the statutory mandate to carry on the business of the bank to the extent required to effect a restructuring transaction or a sale. If CDIC is continuing to allow the Canadian Clearing Member to make ordinary course transfers and payments to LCH in order to avoid termination of the contracts or relationship, it is in our view unlikely that it or a liquidator would seek to recover those payments if the Canadian Clearing Member later became subject to a WURA proceeding.

4.2 ***Are there any circumstances (such as the commencement of Reorganization 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.***

The answer is the same as the answer to question 4.1.

5. RESERVATIONS

Effectiveness of Security

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[67] Coopérants, Mutual Life Insurance Society (Liquidator of) v. Dubois, [1996] 1 SCR 900; Central Guaranty Trust Co. v. Hees International Bancorp Inc., 2001 CarswellOnt 3329, 2001 CarswellOnt 3329, [2001] O.J. No. 3681, which considered CDIC involvement a factor militating against a preferential intent.

[68] *Re Van der Like* at 231-232; *Forbes (Bankrupt), Re*, 2011 MBCA 41 (CanLII).

5.1 We express no opinion as to whether a Canadian 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, or as to the existence or value of any such assets or rights;

5.2 Our opinions are subject to the creation of such security interest not requiring any authorisation, consent or fulfilment of any other pre-condition or formality which has not been satisfied, obtained or done.

5.3 Except to the limited extent expressly addressed in this opinion in paragraph 3.22, we express no opinion as to the priority of any security interest created by the Security Deed or Deed of Charge, including with respect to any consensual secured creditors or statutory, Crown or other deemed trust or lien claims.

Application of foreign law

5.4 The parties' choice must be bona fide and legal and there must be no reason for avoiding the choice of law on the grounds of public policy or public order under the laws of the Ontario.

5.5 If any obligation is or is to be performed in a jurisdiction outside Ontario, it may not be enforceable in the Ontario courts to the extent that performance would be illegal or contrary to public policy under the laws of the other jurisdiction. An Ontario court may give effect to any overriding mandatory provisions of the law of the place of performance insofar as they render the performance unlawful or otherwise take into account the law of the place of performance in relation to the manner of performance and to the steps to be taken in the event of defective performance.

5.6 The Ontario Court will not take judicial notice of a law of another jurisdiction, but will require it to be pleaded and proved to its satisfaction by expert testimony. If neither party proves the chosen law, the Ontario Court may apply Ontario law.

5.7 If the chosen law is a procedural law (as characterized by the Ontario Court under Ontario law), the Ontario Court will not apply it. The Ontario Court only applies procedural laws of Ontario.

5.8 An Ontario Court will not apply a chosen law if its application would be characterized under Ontario law as a direct or indirect enforcement of a foreign revenue, expropriatory, penal or other public law.

5.9 An Ontario Court will not apply a chosen law if its application would be contrary to laws of overriding effect. These could include laws imposing licensing or other regulatory requirements or governmental approvals that apply to certain types of agreements, the breach of which could affect enforceability of an agreement. Insolvency laws, as discussed in this opinion, would also fall within this category.

5.10 An Ontario Court will not apply a chosen law if its application would be contrary to the public policy in Ontario.

5.11 We express no opinion on the binding effect of the choice of law provisions in the Opinion Documents insofar as they relate to non-contractual obligations arising from or connected with the Opinion Documents. Non-contractual issues (even if related to a contract), such as claims in tort, property law issues (such as personal property security laws), claims for breach of securities laws, or insolvency laws (such as stays) are subject to their own conflict of law rules and

therefore may be governed by a law different from the law governing the contract.

Post Insolvency Agency Transactions

5.12 LCH may enter into hedging transactions after the commencement of an Insolvency Proceeding for the account of the Canadian Clearing Member. With respect to Other Services, where PCSA section 8 cannot be relied on, it may be necessary to demonstrate that the agency authority of LCH is irrevocable, meaning contractually irrevocable and coupled with an interest as understood under Ontario law if the transactions are to be booked to the Canadian Clearing Member account. While we believe that it would be so characterized, there is no definitive authority on this issue.

6. QUALIFICATIONS

6.1 The courts having jurisdiction in relation to insolvency law in this jurisdiction may give assistance to courts in which concurrent insolvency proceedings have commenced under the laws of another jurisdiction. Such assistance may take the form of, for example, selectively applying provisions of foreign law in Insolvency Proceedings which are otherwise generally governed by Canadian law. The courts of this jurisdiction may accordingly apply foreign systems of law rather than Canadian law where the Canadian Clearing Member is subject to insolvency proceedings in another jurisdiction.

This advice is given for the exclusive benefit of the addressee. In this opinion we do not assume any obligation to notify or inform you of any developments subsequent to its date that might render its content untrue or inaccurate in whole or in part at such time. It may not, without prior written consent, be relied on by any other person. We consent to a copy of this advice being made publically available on the addressee's website and to it being shown to the Bank of England, the U.S. Commodities and Futures Trading Commission, the Federal Reserve, the U.S. Securities and Exchange Commission, the Ontario Securities Commission and/or any counsel appointed by the addressee to advise on matters of the laws of other jurisdictions, for information purposes only and solely on the basis that we assume no responsibility to any such parties as a result or otherwise.

Yours faithfully

Stikeman Elliott LLP

Schedule 1 – CLEARING MEMBERSHIP AGREEMENT

Schedule 2 – DEED OF CHARGE

APPENDIX A

DEFINITION OF ELIGIBLE FINANCIAL CONTRACT

An "eligible financial contract" is:

(a) a derivatives agreement, whether settled by payment or delivery, that

  (i) trades on a futures or options exchange or board, or other regulated market, or

  (ii) is the subject of recurrent dealings in the derivatives markets or in the over-the-counter securities or commodities markets;

(b) an agreement to

  (i) borrow or lend securities or commodities, including an agreement to transfer securities or commodities under which the borrower may repay the loan with other securities or commodities, cash or cash equivalents,

  (ii) clear or settle securities, futures, options or derivatives transactions, or

  (iii) act as a depository for securities;

(c) a repurchase, reverse repurchase or buy-sellback agreement with respect to securities or commodities; ...

(d) any combination of agreements referred to in any of paragraphs (a) to (d);

(e) a master agreement in so far as it is in respect of an agreement referred to in any of paragraphs (a) to (e);

(f) a master agreement in so far as it is in respect of a master agreement referred to in paragraph (f);

(g) a guarantee of, or an indemnity or reimbursement obligation with respect to, the liabilities under an agreement referred to in any of paragraphs (a) to (g); and

(h) an agreement relating to financial collateral, including any form of security or security interest in collateral and a title transfer credit support agreement, with respect to an agreement referred to in any of paragraphs (a) to (h).

...

A "derivatives agreement" is:

... a financial agreement whose obligations are derived from, referenced to, or based on, one or more underlying reference items such as interest rates, indices, currencies, commodities, securities or other ownership interests, credit or guarantee obligations, debt securities, climatic variables, bandwidth, freight rates, emission rights, real property indices and inflation or other macroeconomic data and includes

(a) a contract for differences or a swap, including a total return swap, price return swap, default swap or basis swap;

(b) a futures agreement;

(c) a cap, collar, floor or spread;

(d) an option; and

(e) a spot or forward

APPENDIX B

DEFINITIONS – IN ALPHABETICAL ORDER

CDIC – Canada Deposit Insurance Corporation

CDIC Act – *Canada Deposit Insurance Corporation Act* (Canada)

Clearing House General Stay Exemption – The exemption from the General Stay under s.39.15(3.2) of the CDIC Act

CSD – Central securities depository

EFC – Eligible Financial Contract as defined under the WURA and CDIC Act regulations

EFC General Stay Exemption – The stay exemption under s. 39.15(7) of the CDIC Act

financial assistance undertaking – the undertaking of CDIC to provide the financial assistance that the member institution requires in order to discharge its obligations to the clearing house

General Stay – The automatic stay on termination or acceleration of contractual rights under s. 39.15(1) of the CDIC Act

Insolvency Proceeding – A liquidation proceeding under the WURA

Intermediary – a custodian, nominee or other securities or financial intermediary

member institutions – federal deposit taking financial institutions that are members of CDIC

PCSA – Payment Clearing and Settlement Act (Canada)

PPSA – Personal Property Security Act (Ontario)

Resolution – The reorganization process commenced by the making of a Resolution Order

Resolution Order - an order under s.39.13(1) of the CDIC Act

Resolution Events – insolvency, transfer of contract, transfer to a third party, the making of the order or conversion (as defined in this opinion)

Resolution Override – The prohibition on relying on Resolution Events to trigger rights to terminate or accelerate or deal with financial collateral with respect to EFCs under s. 39.15(7.101) to (7.105) of the CDIC Act

STA- *Securities Transfer Act* (Ontario)

Superintendent- federal Superintendent of Financial Institutions

Winding-up – A liquidation under the WURA

WURA – *Winding-up and Restructuring Act* (Canada)

WURA EFC Stay Exemption – The stay exemption under s.22.1 of the WURA