

**IMPORTANT NOTE:** This Notice to Singapore Clearing Members is provided for information purposes only and does not constitute a full description of the clearing services offered by the Clearing House to Singapore Clearing Members (as defined below) nor a recommendation to such clearing members (or their clients) to make use of such clearing services. Accordingly, no Singapore Clearing Member may rely upon the contents of this Notice and should make its own decision regarding the clearing services provided by the Clearing House based on independent advice from its professional advisors.

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## Notice to Singapore Clearing Members

### 1. Introduction

LCH Limited (“**Clearing House**”) has obtained recognition from the Monetary Authority of Singapore (“**MAS**”) as a recognised clearing house pursuant to the provisions of the Securities and Futures Act, Chapter 289, of Singapore (“**SFA**”) and the Securities and Futures (Clearing Facilities) Regulations 2013. On the basis of this recognition, the Clearing House proposes to offer certain clearing services, including its SwapClear Clearing Service and ForexClear Clearing Service to clearing members which are incorporated and located in Singapore (each, a “**Singapore Clearing Member**”).<sup>1</sup> The information contained in this Notice is intended to identify certain important legal, regulatory and contractual aspects of a Singapore Clearing Member’s use of these clearing services.

Capitalised terms used, but not otherwise defined, in this Notice shall have the meanings set forth in the Clearing House’s Regulations, Procedures, Default Rules, and Settlement Finality Regulations, each as amended from time to time (collectively, the “**Rulebook**”).

Singapore Clearing Members are reminded that they are required to provide a copy of the corresponding “Notice to Singapore Clearing Clients” to each of their clearing clients located in Singapore (“**Singapore Clearing Client**”), if any, prior to providing such clients with access to the Clearing House’s clearing services.<sup>2</sup>

### 2. Governing Law

#### 2.1 *In General*

Each Singapore Clearing Member is required to enter into a Clearing Membership Agreement with the Clearing House, which binds the Singapore Clearing Member to the provisions of the Rulebook. The Rulebook establishes the contractual arrangements between clearing members

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<sup>1</sup> This Notice has been prepared on the basis that a Singapore Clearing Member is a company incorporated and located in Singapore. A Clearing Member that is not a Singapore-incorporated company should consult with its professional advisors to determine the legal and regulatory requirements that may be applicable to it.

<sup>2</sup> As used herein, the term “Singapore Clearing Client” also includes a Singapore branch of a non-Singapore entity.

and the Clearing House, and provides in particular that the Rulebook and all cleared contracts registered by the Clearing House are governed by, and will be construed in accordance with, English law. The Clearing House and each clearing member consent to the exclusive jurisdiction of the courts of England and Wales to hear and determine any claim or matter arising in respect of the Rulebook or any cleared contracts registered by the Clearing House.

The enforceability of the Rulebook in accordance with its terms is supported by legal opinions in various jurisdictions, including Singapore.<sup>3</sup>

## 2.2 *Rights and Remedies of Clearing Members*

The Rulebook generally provides clearing members with limited rights and remedies against the Clearing House. A discussion of the scope of certain key rights and remedies available to Singapore Clearing Members is set out below.

### (a) Limitation of Liability

The Clearing House is only liable to clearing members in limited circumstances. Specifically, the Rulebook provides that, in respect of the SwapClear and ForexClear Clearing Services, neither the Clearing House nor any member of the LCH Group is liable to any other person in contract, tort (including negligence), trust, as a fiduciary or under any other cause of action in respect of any damage, loss, cost or expense of whatsoever nature suffered or incurred as a result of: any suspension in the relevant clearing service, temporary or otherwise; any refusal by the Clearing House to register a trade that does not meet the relevant eligibility criteria; any action taken by the Clearing House pursuant to the Regulations in the event of market disorders or force majeure; the failure or malfunction of any systems, communication lines or facilities, software or technology supplied, operated or used by the Clearing House or its agents; the occurrence of any event that is outside the Clearing House's control; or any exercise (or decision not to exercise) by the Clearing House of its discretion pursuant to the Rulebook.

This limitation on liability extends to cover indirect or consequential loss or damage, or loss of anticipated profit or bargain, suffered or incurred by a clearing member as a result of the negligence of the Clearing House or of any member of the LCH Group, as well as any damage, loss, cost or expense suffered or incurred by a clearing member as a result of a service failure by a payment or securities service provider such as a custodian, settlement agent, securities depository, securities settlement system, settlement facility or central bank.

These limitations on liability do not, however, apply in respect of any fraud, fraudulent misrepresentation, or wilful default by the Clearing House, or for any personal injury or death caused by the negligence of the Clearing House. The Clearing House also accepts liability for any actions it takes as part of the SwapClear and ForexClear default management plans and for the information distributed to SwapClear and ForexClear clearing members in connection with such default management activities.

### (b) Disciplinary Proceedings

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<sup>3</sup> See: <http://www.lchclearnet.com/members-clients/members/fees-ltd/annual-account-structure-fees>.

Where a clearing member is alleged to have breached an obligation set out in the Rulebook, the Clearing House has established procedures for investigating such alleged breach and for empanelling a disciplinary committee to hear the relevant evidence and make a non-binding recommendation to the Clearing House. The relevant disciplinary procedures provide a clearing member with notice of any investigation and an opportunity to provide a statement of defence to the allegations. Clearing members are permitted to attend disciplinary hearings along with relevant experts and legal and accounting advisors.

Any decision by the Clearing House must be in writing, and detail the grounds on which the decision has been made. A clearing member may appeal a decision as described in greater detail in (d) below.

(c) Appeals

Clearing members are permitted to appeal against various decisions by the Clearing House, including: a decision relating to the scope of its clearing membership; a decision to rescind a clearing member's right to have certain types of contracts registered in its name; a decision to terminate a clearing member's membership (other than in a default situation); and a decision made pursuant to the Clearing House's disciplinary procedures. Any appeal must be commenced within 28 days of the date the relevant decision was notified to the appellant, subject to extension by the Clearing House's chief executive.

There are two tiers to the appeal process. In the first-tier appeal, an appellant submits a written form to the Clearing House, which then empanels an appeal committee consisting of the Clearing House's chief executive and two directors nominated by the Clearing House's chairman; an exchange nominee may participate where the appeal relates to activity on such exchange. The appeal committee may request written submissions from the appellant and may not hold an oral hearing. The committee's decision may dismiss or allow (in whole or in part) the appeal and may increase or decrease any disciplinary sanctions imposed.

A dissatisfied appellant may then lodge a second-tier appeal, which will be heard by a three-member tribunal. The appellant and Clearing House each choose one member from a pre-selected group nominated by The Centre for Dispute Resolution, which itself nominates the chairperson. The tribunal will invite submissions from the appellant and the Clearing House, and will convene a hearing where it may hear evidence and permit cross-examinations. The tribunal will record its decision in a written statement, including its reasons, in which it may dismiss or allow (in whole or in part) the appeal. The Clearing House is then required to review and reconsider the original appeal based on the content of the tribunal's written decision.

(d) Complaints

The Clearing House has established a complaint procedure that permits a clearing member to make a formal complaint relating to, *inter alia*, the performance of, or failure to perform, any of the Clearing House's regulatory functions. A complaint must be submitted in writing and include certain required information. The Clearing House then must undertake an internal investigation and prepare a written report and make such remediation recommendations it sees fit.

A dissatisfied complainant may then refer the matter to an independent investigator to be nominated by The Centre for Dispute Resolution, who will conduct its own investigation. The

independent investigator must prepare and deliver a written report, including such remediation recommendations it sees fit.

(e) No Third Party Rights

For purposes of the Contracts (Rights of Third Parties) Act 1999, the Rulebook does not, save as expressly provided otherwise, create any rights in any person that is not a clearing member.

### 3. Protection of Singapore Clearing Member Funds and Assets

The Clearing House is required to keep separate records and accounts sufficient to enable it, at any time, to identify the assets and positions held for the account of a particular Singapore Clearing Member from the assets and positions of all other clearing members and from the assets and positions of the Clearing House itself. However, there are no other provisions in applicable UK law or the Rulebook that provide any additional protections to the house/proprietary funds and assets of a clearing member.

Accordingly, in the event of a Singapore Clearing Member's insolvency, the funds and assets deposited with the Clearing House will be available to meet all losses relating to such clearing member's accounts with the Clearing House. For the avoidance of doubt, this obligation extends to using house/proprietary funds and assets to cover losses attributable to any of the defaulting clearing member's client accounts. Furthermore, in the event of the Clearing House's insolvency, there are no protections available in respect of any funds or assets deposited with the Clearing House, in which case the Singapore Clearing Member would generally be an unsecured creditor of the insolvent estate and may be unable to recover all of such amounts in the insolvency proceedings.<sup>4</sup>

### 4. Clearing House Insolvency

In the event of the Clearing House's insolvency, any rights against the Clearing House under the principal-to-principal clearing model remain with clearing members only. Accordingly, clearing members must rely on applicable rights and remedies available pursuant to the Rulebook. Although applicable English and Singapore law should not ordinarily operate to interfere with a Singapore Clearing Member's exercise of its rights available pursuant to the Rulebook in the event of the Clearing House's insolvency, Singapore Clearing Members should consult with their professional advisors for further information on the enforceability of the Rulebook provisions set out below in the event of the Clearing House's insolvency.

#### 4.1 *The Netting Rule*

The Clearing House has adopted Regulation 45 ("**Netting Rule**") that sets out the actions that its clearing members may take upon the insolvency of the Clearing House. Very generally, the Netting Rule provides that each clearing member must calculate one or more amounts (each, a "**Termination Amount**") in respect of the losses and gains attributable to each of its cleared positions with the Clearing House. Where a clearing member has both house accounts as well as one or more client accounts, the clearing member is required to determine one net amount in respect of gains and losses registered to each client account and a separate amount in respect

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<sup>4</sup> Certain non-cash assets may be deposited with the Clearing House from time to time pursuant to a Deed of Charge. A Singapore Clearing Member should consult its professional advisors regarding the rights of a chargor over assets deposited with a chargee upon the chargee's insolvency.

of gains and losses arising in respect of its house account. A Singapore Clearing Member may therefore be required to calculate a number of separate Termination Amounts.

Where a Termination Amount is a positive number, it is payable by the Clearing House to the relevant clearing member; where a Termination Amount is a negative number, it is payable by the relevant clearing member to the Clearing House. The clearing member is permitted to set off any or all amounts due as between the Clearing House and the clearing member, including in respect of one or more proprietary accounts of the clearing member. No such setting off is permitted across client accounts or across a proprietary account and a client account.

#### 4.2 *English Law*

Although a CCP insolvency has never been tested under the UK law of insolvency, there are several potential sources of English law that may serve to protect Singapore Clearing Members' ability to exercise their rights under the Netting Rule.

For example, there are rules under UK law which provide for the enforceability of a CCP's default rules as well as its arrangements in respect of netting, closing out of open positions and the application or transfer of collateral security.

For instance, Part VII of the Companies Act 1989 ("**Part VII**") generally protects the actions taken by a recognised clearing house under its default rules in respect of a defaulter from the application of the ordinary UK law of insolvency, these protections may also apply in a limited fashion to insolvency proceedings of a person other than a "defaulter" in order to protect "market contracts". Therefore, to the extent that the Netting Rule falls within the scope of this protection of market contracts, Part VII may provide additional authority for Singapore Clearing Members to exercise their rights under the CCP Contracts in the event of the Clearing House's insolvency. This position has never been tested in an English court, and Singapore Clearing Members are encouraged to obtain independent advice from their professional advisors in this regard.

#### 4.3 *Singapore Law*

In respect of certain transactions or class of transactions prescribed by the MAS that are cleared or settled by, *inter alia*, a recognised clearing house such as LCH, the SFA provides that, notwithstanding any other written law or rule of law, a Singapore court shall not recognise or give effect to:

- (a) an order of a court exercising jurisdiction under the law of insolvency in any place outside Singapore; or
- (b) an act of a person appointed in any place outside Singapore to perform a function under the law of insolvency in that place,

insofar as the making of the order by a court in Singapore, or the doing of the act by a relevant office holder, would be prohibited under the SFA.<sup>5</sup>

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<sup>5</sup> In the case of a corporation, a relevant office holder refers to the liquidator, provisional liquidator, receiver, receiver and manager or judicial manager of the corporation, or a person acting in an equivalent capacity in relation to the corporation.

Accordingly, the provisions of the SFA may provide a measure of protection from Singapore insolvency law in the event of the Clearing House's insolvency, insofar as the relevant English proceedings were not in conflict with SFA requirements. Given that the Clearing House is in the United Kingdom and its assets are not in Singapore, the likely potential impact of Singaporean insolvency law in the case of insolvency of the Clearing House may be limited. Accordingly, for most purposes, the position under English law and practice in the case of an insolvency of the Clearing House would be of primary importance.

#### 4.4 *Special Resolution Regime*

The ability of a Singapore Clearing Member to exercise its rights under the Netting Rule may be affected by the Special Resolution Regime (“**SRR**”) provisions of the Banking Act 2009. The SRR provisions apply in respect of the resolution of recognised CCPs, including the Clearing House. In particular, the Bank of England is given the following stabilisation powers: (1) the power to transfer some or all of a CCP's business to a private purchaser; (2) the power to transfer some or all of a CCP's business to a “bridge” CCP wholly owned and controlled by the Bank of England; and/or (3) the power to transfer the ownership of a CCP to any other person. The Bank of England is subject to a number of standards that must be met prior to exercising, and during the exercise, of any such powers.

The exercise of transfer powers is also subject to certain safeguards, including the following: (1) requiring the transfer of all, but not some, of a segregated business line of a CCP, which is defined as a product set cleared by a CCP and supported by a single default fund; (2) preventing any partial transfer that would render a market contract unenforceable; and (3) prohibiting the transfer of any liability without also transferring any security attaching to such liability. The SRR regime is also subject to an overriding “no creditor worse off” principle, in effect providing the potential for a compensation payment to any creditor of a CCP (which may include a Singapore Clearing Member) that receives less as a consequence of the SRR regime than that creditor would have received in an ordinary insolvency proceeding.

The foregoing safeguards should minimise the potential losses to a Singapore Clearing Member upon the application of any SRR resolution powers upon the insolvency of the Clearing House. In particular, the Singapore Clearing Member's positions and assets would only be transferred *in toto*, thereby assuring that its overall economic position – and that of its clients – would remain constant, subject to the backstop “no creditor worse off” principle to compensate for any losses that do occur.

## 5. **Taxation**

***IMPORTANT NOTE:** The comments in this section are of a general, high level nature and relate to the possible United Kingdom or Singaporean (as the case may be) tax treatment of financial traders who are a party to derivative contracts (“**DCs**”) as principal (and not as trustee, agent, nominee or other capacity) and which are constituted as corporate entities and separate legal persons (excluding partnerships, trusts or similar vehicles or entities) that are trading in the relevant DCs which are cleared through the Clearing House. The comments are based on the legislation and generally published practice of HM Revenue and Customs (“**HMRC**”) and the Inland Revenue Authority of Singapore (“**IRAS**”) as at the date of this document. Persons reading this general disclosure should note that the following statements are not to be regarded as advice on the tax position of any financial trader or counterparty to a DC and any financial trader and/or counterparty to a DC should consult their own*

*professional tax advisers as to any tax implications that may arise from the execution or performance of DCs and their clearing of DCs through the Clearing House.*

## 5.1 Corporate / Income Taxes

### (a) United Kingdom

A counterparty to a DC transaction will be subject to UK corporation tax in respect of its profits derived from the transaction if it is within the scope of UK corporation tax generally (currently at the rate of 20%, reducing to 19% in 2017 and 18% in 2020).

#### (1) UK Tax Residence

If the DC counterparty is tax resident in the UK, it will be taxable on its worldwide profits and gains, including any profit from its DC transactions. As a corporate entity, it would be UK tax resident if it were UK-incorporated or UK centrally managed and controlled (subject to effect of any applicable treaty tie-breaker). However, without more, a DC trader's residence should be unaffected by virtue of clearing DC transactions through LCH.

#### (2) Trading in the UK through a UK Permanent Establishment (“**UK PE**”)

A non-UK tax resident DC trader that uses a UK based agent or broker or otherwise books its trades through a UK branch or office (in any such case, constituting a UK PE of the DC trader) would be subject to UK corporation tax on any profits derived from trading through that UK PE. On the assumption that the LCH clearing process does not involve any explicit or implied agency arrangements, a DC trader should not generally acquire a UK taxable PE solely by virtue of clearing DC transactions through LCH. In this regard, it should be noted that the OECD's ongoing work on “Base Erosion and Profit Shifting” may lead to changes of law and HMRC practice in the UK and may have an impact on the UK's approach to PEs generally.

#### (3) UK Tax Treatment for DC Transactions

Where the DC trader is taxable in the UK, the UK's DC Tax Regime (Part 7 of the Corporation Tax Act 2009) will most likely apply, with the effect that credit and debit amounts arising under the DCs will be taxed or relieved as income, broadly in accordance with their accounting treatment. In certain cases (for example, certain types of equity and real property based DCs), capital gains, rather than income, treatment is prescribed. The DC Tax Regime is a complex area of law and it is currently under review with a view to updating and clarifying its application, but in general, its application should be unaffected by virtue of clearing DC transactions through LCH.

### (b) Singapore

A DC trader will generally be subject to Singapore income tax in respect of its income or profits derived from DC transactions if the income or profits are considered to be accrued in or derived from Singapore (or deemed as such) (“**Singapore-sourced income**”), or if the profits or income are accrued or derived from outside Singapore (“**foreign-sourced income**”) and received in Singapore (or deemed as such), unless otherwise exempted and subject to certain exceptions.

There is no statutory test as to what comprises Singapore-sourced income and what comprises foreign-sourced income. Broadly speaking, one would look to where the activities giving rise to the income are carried out to determine the jurisdictional source of the income.

The profits of a non-Singapore DC trader who uses a Singapore based agent or broker or who otherwise carries out the trade involving activities, or an office, in Singapore may be regarded (in whole or in part) as taxable Singapore-sourced income, or (where a double taxation treaty applies) as taxable income attributable to a Singapore permanent establishment of the non-Singapore DC trader. As a further illustration, if a non-Singapore DC trader does not carry out any activities in Singapore when trading with LCH in London, and LCH carries out all activities outside Singapore when trading with this non-Singapore DC trader, the profits of this non-Singapore DC trader from trading with LCH in London should not be subject to Singapore income tax.

The prevailing corporate income tax rate in Singapore is 17% (with a partial tax exemption for the first SGD300,000 of taxable income) and concessionary tax rates may be available under certain circumstances and for certain taxpayers.

## 5.2 *Withholding Tax (“WHT”)*

### (a) United Kingdom

In principle, UK WHT (tax deducted by a payer on account of UK income tax) can potentially apply to UK source payments made under DCs on the basis that those amounts constitute interest or “annual payments”. However, the UK’s DC Tax Regime provides an exemption from UK WHT in respect of all payments made under DCs which fall within the DC Tax Regime. On the basis that LCH-cleared DCs should generally fall within the DC Tax Regime, UK WHT should not apply to payments made under those DCs.

To the extent that LCH-cleared DCs fall outside the DC Regime, further consideration would need to be given to the nature of the relevant payments (e.g. whether income or capital for tax purposes) and whether those payments have a UK source for tax purposes (including the impact on the latter, if any, of clearing through UK based LCH participants acting as principal). If UK WHT potentially applies, specific UK WHT exemptions may apply to eliminate the WHT and/or relief may be available under an applicable double taxation treaty.

### (b) Singapore

Singapore WHT may apply to payments made under the DCs by Singapore parties to non-Singapore tax resident parties (for example, an LCH participant in London) if the payments comprise certain types of payments that attract Singapore WHT, for example, interest or other payments in connection with any loan or indebtedness. In relation to LCH cleared DCs, further analysis should be conducted to determine whether the payments (for example, the payments to be made to an LCH participant in London) fall within the Singapore WHT regime, and if so, whether any Singapore WHT exemption is available and/or whether relief is available under an applicable double taxation treaty.

## 5.3 *Financial Transactions Tax (“FTT”)*

Following failed attempts to achieve unanimous EU-wide agreement on an EU-wide FTT, in January 2015, 11 EU Member States issued a Joint Statement re-iterating their commitment to

implement an FTT. There was little information on the proposed scope of the FTT beyond calling for a wide tax base and low tax rates.

Reports of progress since that time have been very limited. Accordingly, whilst the relevant EU finance ministers remain publicly committed to a commencement date of 1 January 2016, the likelihood of an FTT being introduced within that time frame appears doubtful.

If agreed, the enactment of an EU-wide FTT would fundamentally change the taxation of DCs, including DCs cleared through the Clearing House. Singapore Clearing Members should therefore inform themselves of the progress of the development of an EU-wide FTT regime.

## **6. Protection of Singapore Clearing Client Funds and Assets**

***IMPORTANT NOTE:*** The contents of this Section 6 have been prepared on the basis that a Singapore Clearing Member will grant access to the Clearing House's clearing services only to clearing clients that are Singapore Clearing Clients. A Singapore Clearing Member that provides access to the Clearing House's clearing services to clearing clients located in another jurisdiction should consult its professional advisors to determine the relevant legal and regulatory requirements that may apply.

The Clearing House operates a principal-to-principal clearing model, in which the relevant clearing member does not contract with the Clearing House as the agent of an underlying clearing client. Instead, the clearing member contracts with the Clearing House as principal, and the underlying clearing client contracts with the clearing member as principal, on a matched-principal basis. There are therefore two separate sets of contracts in a principal-to-principal model: (1) contracts between the Singapore Clearing Member and the Clearing House ("**CCP Contracts**"), which are governed by the provisions of the Rulebook; and (2) "back-to-back" contracts between the Singapore Clearing Client and the Singapore Clearing Member ("**Client Contracts**"), which are governed by the terms of the customer clearing agreement between the Singapore Clearing Client and its Singapore Clearing Member.

As a consequence of these two related, but separate, sets of contracts, a Singapore Clearing Client will deposit funds and assets with its Singapore Clearing Member in connection with its clearing activities at the Clearing House, and such funds and assets will be governed by the customer protection requirements set out in the SFA and the Securities and Futures (Licensing and Conduct of Business) Regulations (the "**LCB Regulations**"). In turn, the Singapore Clearing Member will deposit funds and assets on behalf of its Singapore Clearing Clients with the Clearing House, which will be governed by the customer protection requirements in relevant primary and secondary UK legislation.

Under the LCB Regulations, a Singapore Clearing Member must deposit funds or assets received from its customers in a trust or custody account maintained with certain specified financial institutions by the business day following the day of receipt and keep such an account separate from any other account in which the Singapore Clearing Member deposits its own funds or assets. These funds and assets may in certain circumstances be deposited with a clearing house or invested/pledged. Otherwise, the assets cannot be withdrawn unless the withdrawal is for one of the purposes set out in the LCB Regulations.

By contrast, the Clearing House will not hold funds and assets received from its Singapore Clearing Members on trust for its Singapore Clearing Clients; instead, funds and assets attributable to Singapore Clearing Clients will be held in accordance with applicable

segregation and recordkeeping requirements.<sup>6</sup> Singapore Clearing Members should therefore assure themselves that their arrangements for the receipt of funds and assets from Singapore Clearing Clients, on the one hand, and the deposit of funds and assets with the Clearing House on behalf of such Clients, on the other hand, complies with applicable legal and regulatory requirements.

## **7. Other**

Initial margin requirements for all SwapClear products, including those denominated in Singapore Dollars, are calculated in Pounds Sterling (for clients of FCMs, the requirement is calculated in Pounds Sterling and expressed in US Dollars). A list of eligible collateral is made available on the Clearing House's website. Where clearing members acting for Singapore Clearing Clients post collateral on client positions for Singapore Dollar-denominated instruments, they will face a foreign exchange risk. Clearing members acting for Singapore Clearing Clients must also operate payment arrangements in London and New York and ensure that their Protected Payment System (“**PPS**”) banks are able to act upon margin call and payment instructions issued in accordance with the rules of the PPS.

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<sup>6</sup> See <http://www.lhclearnet.com/members-clients/members/fees-ltd/annual-account-structure-fees>; see also <http://www.lhclearnet.com/documents/731485/762508/Account+Structure+Brochure>.