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Dear Sirs

Supplemental opinion on close-out netting under English law

We refer to our memorandum of law dated 12 December 2011 addressed to the International Swaps and Derivatives Association, Inc. (**ISDA**) regarding the validity and enforceability under English law of close-out netting under the 2002, 1992 and 1987 ISDA Master Agreements (the **ISDA Netting Opinion**). A capitalised term used without definition in this letter has the meaning given to that term in the ISDA Netting Opinion.

1. Purpose of this supplemental opinion

In part I.3 of the ISDA Netting Opinion, we set out the types of Counterparty covered by the ISDA Netting Opinion. You have asked us to extend the scope of the ISDA Netting Opinion to include the following types of Counterparty:

(a) the trustee (a **Trustee**) of a trust governed by English law that is not subject to a special regulatory regime (an **English Trust**);

(b) an Insurance Company, if authorised by the Financial Services Authority under Part IV of the Financial Services and Markets Act 2000 with permission to carry on insurance business, that is, to effect and carry out contracts of insurance (which includes reinsurance) as principal and established as a body corporate under English law in one of the following forms (in each case, an **English Insurance Company**):

(i) a company registered under the Companies Act 2006 with its registered office in England (a **Companies Act Company**);[1]

(ii) a friendly society incorporated under the Friendly Societies Act 1992 with its registered office in England (a **Friendly Society**);[2]

[1] Under section 1 of the Companies Act 2006 this includes a company formed and registered under the Companies Act 2006 as well as a company formed and registered under a prior companies statute or, in certain cases, formed under other English legislation or by virtue of letters patent (royal charter). This does not include branches of foreign corporations (referred to as "overseas companies" in the Companies Act 2006) registered under Part 34 of the Companies Act 2006.

(iii) an industrial and provident society registered under the Industrial and Provident Societies Act 1965 with its registered office in England (an **I&P Society**);[3]

(iv) a body corporate established by private Act of Parliament with its principal place of business in England (a **Statutory Corporation**);[4] or

(v) a body corporate established by royal charter granted by the Crown with its principal place of business in England (a **Chartered Corporation**);

(c) an English registered charity within the meaning of section 1 of the Charities Act 2006[5] and established either as a trust governed by English law (an **English Charitable Trust**) or as a body corporate under English law in one of the following forms (each, an **English Charity**, which term includes the Trustee(s) of an English Charitable Trust, unless context indicates otherwise):

(i) a Companies Act Company;[6]

(ii) a Friendly Society;

(iii) an I&P Society;

(iv) a Statutory Corporation; or

(v) a Chartered Corporation;

(d) an Investment Fund organised under English law in one of the following forms:

(i) an open-ended investment company with variable capital (**Open-Ended Investment Company**) incorporated and registered under the Open-Ended Investment Company Regulations 2001[7] (the **OEIC Regulations**) with the Financial Services Authority with its registered office in England; or

(ii) as a trust authorised as a unit trust scheme (an **Authorised Unit Trust**) by the Financial Services Authority for the purposes of the Financial Services and Markets Act 2000 by an authorisation order in force under section 243 of the Financial Services and Markets Act 2000;

(an Open-Ended Investment Company and the Trustee of an Authorised Unit Trust, being each an **English Investment Fund**).

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2 A friendly society may also be unincorporated and registered under the Friendly Societies Act 1974, however such friendly societies are excluded from the scope of this supplemental opinion. In addition, there are some unincorporated and unregistered friendly societies to which the legislation relating to friendly societies has no direct application. These friendly societies are associations of individuals with property commonly vested in trustees. An unincorporated and unregistered friendly society may not be authorised to conduct insurance business under the Financial Services and Markets Act 2000 and so are also excluded from the scope of this supplemental opinion.

3 From a date to be appointed, by virtue of section 2 of the Co-operative and Community Benefit Societies and Credit Unions Act 2010, the Industrial and Provident Societies Act 1965 will be re-named the Co-operative and Community Benefit Societies and Credit Unions Act 1965 and each I&P Society currently registered under the 1965 Act will be a "pre-2010 Act society" for the purposes of the 1965 Act. This will, however, have no effect on the status of the I&P Society under the 1965 Act.

4 Note that this definition does not include a statutory corporation established under a public general Act of Parliament. Excluding Companies Act Companies (which are not normally referred to as "statutory corporations" in England), a corporation established under a public general Act of Parliament is normally established for a governmental, regulatory or other public purpose. Examples include local authorities (for example, the county councils and county borough councils established by the Local Government Act 1888), the Board of the Pension Protection Fund (established by the Pensions Act 2004) and the Olympic Delivery Authority (established by the London Olympic Games and Paralympic Games Act 2006).

5 Section 1 of the Charities Act 2006 defines "charity" as "an institution which: (a) is established for charitable purposes only; and (b) falls to be subject to the control of the High Court in the exercise of its jurisdiction with respect to charities".

6 An English Charity established as a Companies Act Company is normally established as a company limited by guarantee, that is, without share capital.

7 SI 2001/1228.

Each of these Counterparty types requires separate analysis because each is subject to a separate insolvency regime. It is therefore necessary to consider whether any rule of the relevant insolvency regime could affect the validity or enforceability of close-out netting under the ISDA Master Agreement in the event of insolvency proceedings affecting the Counterparty.

You have also asked us to extend the scope of the ISDA Netting Opinion to include:

(e) the Bank of England, which is a Central Bank; and

(f) the United Kingdom acting through Her Majesty's Treasury, which is a Sovereign.

Each of these Counterparties requires a separate analysis given its unique nature.

For convenience of reference, we set out in Appendix I to this supplemental opinion a revised form of Appendix B to the ISDA Netting Opinion, to reflect the expanded scope of the ISDA Netting Opinion as amended and supplemented by this supplemental opinion.

2. Scope of this supplemental opinion

2.1 *Trusts and trustees under English law*

(a) <u>Nature of a trust and the personal liability of a Trustee</u>

In relation to an English Trust, an English Charitable Trust and an Authorised Unit Trust, it is important to note that a trust is not a legal person under English law. The trust is not capable therefore of entering into contracts or of suing or being sued in relation to any contract or other matter. Therefore one contracts with one or more Trustees on behalf of the trust. Each Trustee is personally liable for any obligations it incurs under the contract, but is not, in its capacity as a Trustee, beneficially entitled to any rights under the contract, such rights being held by each Trustee for the benefit of the beneficiaries of the trust.

For this reason, in this supplemental opinion we consider the enforceability of close-out netting under an ISDA Master Agreement against a Trustee of an English Trust, English Charitable Trust or Authorised Unit Trust, as the case may be, rather than against the relevant trust.

(b) <u>Trustee's right of recourse to the assets of a trust</u>

Although a Trustee is personally liable for its obligations under a contract it enters into on behalf of the trust, it may seek to limit that personal liability to the extent of its right of recourse against the assets of the trust. Note that a Trustee is not able to exclude its personal liability entirely. The effect of such a limitation in a contract is simply to exclude the right of the other party to enforce the contract against its personal assets should the trust assets be insufficient to satisfy a claim against the Trustee arising under the contract.

Even in the absence of such a limitation on the liability of the Trustee, a creditor of the Trustee normally relies on the assumption that the Trustee has a right of recourse to the assets of the trust to fulfil its obligations incurred under a contract made on behalf of the trust. The personal assets of the Trustee are often wholly inadequate to cover such obligations, particularly in the context of a trust that is of a size justifying recourse to the wholesale derivatives market for risk management purposes.

Accordingly, it is important for a party to ensure as far as possible that a Trustee will be entitled to have recourse to the trust assets in order to meet its liabilities under an ISDA

Master Agreement between the party and the Trustee. There are ways, however, in which a Trustee may lose, partially or wholly, its right of access to the trust assets.

This is not, strictly speaking, a question of enforceability of the contract against the Trustee, and so any such impairment of the Trustee's right of recourse does not affect our analysis of the enforceability of the ISDA Master Agreement, including the close-out netting provisions, against the Trustee, in the absence of insolvency proceedings in England in respect of the Trustee (discussed in part 4 below) or after the commencement of such proceedings (discussed in Annex 1 in relation to the Trustee of an English Trust, in Annex 7 in relation to the Trustee of an English Charitable Trust and in Annex 10 in relation to the Trustee of an Authorised Unit Trust).

In Appendix II to this supplemental opinion, we set out various issues affecting dealing with the Trustee of a trust governed by English law that do not go to the enforceability of the Trustee's contractual obligations under the ISDA Master Agreement but to the question of whether the Trustee (or, in certain circumstances, the other party directly) has recourse to the assets of the trust in order to meet its liabilities and certain other issues of importance when dealing with a Trustee.

(c) Trustees within the scope of this supplemental opinion

A trust may have a single Trustee, which may be a private individual or a corporate Trustee, or it may have two or more Trustees, which may be private individuals, corporate Trustees or a combination of the two.

Where a trust has a single Trustee, it will ordinarily be a corporate Trustee, at least for a trust of a size justifying recourse to the wholesale derivatives market for risk management purposes. If such a trust has more than one Trustee, then normally at least one will be a corporate Trustee.

Where a trust has two or more Trustees, it is not normally necessary under the relevant trust deed that all Trustees enter into each contract. Accordingly, a party may enter into an ISDA Master Agreement with a corporate Trustee to which other Trustees (whether corporate entities or private individuals) of the same trust are not a party. This is not a problem if the Trustee with whom it has entered into the ISDA Master Agreement has the necessary power and authority to enter into the ISDA Master Agreement and each Transaction under the relevant trust deed.

When a party deals with a private individual, including a private individual acting as Trustee, there are a number of additional considerations, both legal and commercial, that arise that would not apply when dealing with a corporate entity. For example, the death or incapacity of a private individual is likely to cause the relationship between the party and the private individual to terminate. Additionally, unfair contract terms legislation and other consumer protection legislation, such as that relating to consumer credit, may affect the relationship between the party and the private individual.

Such matters are not specific to private individuals acting in their capacity as Trustee, but apply to dealings with private individuals generally. For this reason, and as is customary for opinions of this type, we have assumed for the purposes of this supplemental opinion that the Trustee is an English Company, that is, is a corporate Trustee.

It does not, however, affect our analysis of the enforceability of close-out netting under the ISDA Master Agreement against a particular corporate Trustee, that there may be one or more private individual Trustees for the relevant trust who may or may not be a party to the ISDA Master Agreement on behalf of that trust.

One final point to bear in mind in this regard is that a Trustee appointed after the date an ISDA Master Agreement has been entered into will not be bound unless the new Trustee specifically contracts with the other party to the ISDA Master Agreement to assume the obligations of a Trustee under the ISDA Master Agreement. Although the ISDA Master Agreement may state that Party A or Party B consists of "the Trustees of the Trust acting on behalf of the Trust", this language does not impose legal liability on a new Trustee (or, indeed, any other Trustee) that has not entered into the ISDA Master Agreement either directly or through an agent.

(d) Trusts within the scope of this supplemental opinion

We note that an English Charitable Trust and an Authorised Unit Trust are each subject to a specific and detailed regulatory regime. In this supplemental opinion, we consider whether, in each case, the regulatory regime affects the enforceability of close-out netting under the ISDA Master Agreement against a Trustee for the English Charitable Trust or Authorised Unit Trust, as the case may be.

In relation to an English Trust, other than an English Charitable Trust or Authorised Unit Trust, we assume that it is not subject to a specific regulatory regime that may affect the enforceability of close-out netting under the ISDA Master Agreement against a Trustee for the English Trust. We therefore, for example, do not consider in this supplemental opinion an English Trust that is an English occupational pension scheme, given the detailed regulatory regime applicable to such schemes.

2.2 *Legal form of an English Insurance Company, English Charity or English Investment Fund*

This supplemental opinion covers an English Insurance Company established in one of the five legal forms indicated above. This supplemental opinion does not extend to an English insurance company established in any other form, for example, as a form of partnership. It also does not extend to an underwriting member of Lloyd's of London, as a separate insolvency regime would be applicable.[8]

This supplemental opinion covers an English Charity established in one of the six forms indicated above. This supplemental opinion does not extend to an English charity established in any other form, for example, as an unincorporated association.

This supplemental opinion covers an English Investment Fund established in one of the two forms indicated above. This supplemental opinion does not extend to an English investment fund established in any other form.

[8] Insurers (Reorganisation and Winding Up) (Lloyd's) Regulations 2005 SI 2005/1998.

2.3 *Legal capacity and regulatory issues generally*

Each of the Counterparty types you have asked us to consider in this supplemental opinion is potentially subject to requirements under its constitutional document (for example, the trust deed in relation to a trust) or to legal or regulatory requirements that may affect the legality or validity of its entering into certain types of Transaction under an ISDA Master Agreement. It may be, for example, that a Counterparty of that type is only permitted to enter into Transactions for hedging purposes or for the purposes of efficient portfolio management. As in the case of the ISDA Netting opinion, we do not consider such issues in this supplemental opinion.[9]

For the purposes of our consideration of the enforceability of close-out netting under the ISDA Master Agreement (which is the principal purpose of the ISDA Netting Opinion and this supplemental opinion) under English insolvency law, we have assumed in part III.2(g) of the ISDA Netting Opinion that each of the obligations of the parties are legal, valid and binding as a matter of contract under the relevant governing law, whether the parties have chosen English law or the law of the State of New York.

We then consider the basic contractual position in relation to the ISDA Master Agreement in part V of the ISDA Netting Opinion. In part V.2(a) we assume that each party is able lawfully to enter into and has taken all corporate action necessary to authorise entry into the relevant ISDA Master Agreement and each Transaction under that ISDA Master Agreement. Therefore issues of the legal capacity and authority of a Counterparty to enter into any specific type of Transaction is outside the scope of the ISDA Netting Opinion and this supplemental opinion.

More generally, we do not advise in this supplemental opinion on regulatory issues relating to derivatives dealings by any Counterparty type falling within the scope of this supplemental opinion, except to the extent that failure to comply with a regulatory requirement might affect the enforceability of close-out netting under the ISDA Master Agreement against that type of Counterparty.

3. Structure of the supplemental opinion

In Part III of the ISDA Netting Opinion we respond to the questions in the Instruction Letter under the heading "Close-out netting under the ISDA Master Agreement" in relation to a Counterparty that is an English Company, other than an English Bank or English Investment Firm, in the event of insolvency proceedings in England in respect of the English Company.

These questions are then considered in annexes to the ISDA Netting Opinion in relation to additional types of Counterparty, as specified in part III.1 of the ISDA Netting Opinion, in the event of insolvency proceedings in England in respect of each type of Counterparty.

We have noted above that an English Insurance Company and an English Charity may each be established in one of a number of different legal forms, in particular, as a Companies Act Company, Friendly Society, I&P Society, Statutory Corporation or Chartered Corporation. As each of these different legal forms of body corporate is subject to a different insolvency regime, we first consider each of these forms separately and then consider whether and, if so, how the analysis is affected by law or regulation applicable to English Insurance Companies or English Charities, as the case may be.

An English Charity may also, as noted above, be established as an English Charitable Trust, and an Authorised Unit Trust is a form of English Trust. We first consider the general position in relation to

[9] We note, however, that when considering these issues in relation to a corporate Trustee, one should bear in mind the distinction between the capacity of the Trustee in its own right (for example, its capacity to act as a trustee), which will be governed by its own corporate constitution, and the capacity of the Trustee to act on behalf of the trust, which will be governed by statute and the relevant trust deed.

the enforceability of close-out netting under the ISDA Master Agreement against a Trustee of an English Trust and then consider whether and, if so, how the analysis is affected by law or regulation applicable to an English Charity or English Investment Fund.

Our conclusions in Part III of the ISDA Netting Opinion apply in relation to an English Counterparty that is:

(a) the Trustee of an English Trust (other than the Trustee of an English Charitable Trust, an Authorised Unit Trust or any English Trust excluded from the scope of this supplemental opinion under part 2.1 above), as modified and supplemented by Annex 1;

(b) a Friendly Society, as modified and supplemented by Annex 2;

(c) an I&P Society, as modified and supplemented by Annex 3;

(d) a Statutory Corporation, as modified and supplemented by Annex 4;

(e) a Chartered Corporation, as modified and supplemented by Annex 5;

(f) an English Insurance Company, as modified and supplemented by Annex 6;

(g) an English Charity acting through the Trustee of an English Charitable Trust, as modified and supplemented by Annex 7;

(h) an English Charity established in one of the other forms indicated above, as modified and supplemented by Annex 8

(i) an English Investment Fund that is an Open-Ended Investment Company, as modified and supplemented by Annex 9; and

(j) an English Investment Fund acting through the Trustee of an Authorised Unit Trust, as modified and supplemented by Annex 10.

You have also asked us to consider in this supplemental opinion the enforceability of the close-out netting provisions of the ISDA Master Agreement against each of the Bank of England and the United Kingdom acting through Her Majesty's Treasury. As noted above, each requires a separate analysis due to its unique nature.

For reasons discussed in more detail in Annex 11 in relation to the Bank of England and Annex 12 in relation to the United Kingdom acting through Her Majesty's Treasury, neither may, in our view, be made subject to insolvency proceedings in England. Therefore the questions in part III of the ISDA Netting Opinion, which deal with the enforceability of the close-out netting in the event of insolvency proceedings, are not relevant to either of these Counterparties. The reasons for this in each case and additional issues that are relevant to each of these Counterparties are discussed in Annexes 11 and 12, respectively.

4. Enforceability in the absence of insolvency proceedings

In part V of the ISDA Netting Opinion we consider whether the ISDA Master Agreement, including the close-out netting provisions, would be valid and enforceable under English law against a Counterparty falling within the scope of the ISDA Netting Opinion in the absence of insolvency proceedings in England in respect of that Counterparty. In this part 4 of this supplemental opinion we consider whether our conclusion in part V.3 would also apply to each Counterparty falling within the scope of this supplemental opinion in the absence of insolvency proceedings in England in respect of that Counterparty.

4.1 *Assumptions*

Our conclusion in part 4.2 below is made on the basis of the following assumptions:

(a) assumptions (a) to (g) and (i) in part III.2 of the ISDA Netting Opinion, except, in the case of assumption (g), where the parties have chosen English law as the governing law of the ISDA Master Agreement; and

(b) the additional assumptions in part V.2 of the ISDA Netting Opinion.

4.2 *Conclusion*

On the basis of the assumptions in 4.1 above and subject to the qualifications in part V.4 of the ISDA Netting Opinion, we confirm that our conclusion in part V.3 of the ISDA Netting Opinion applies to each Counterparty falling within the scope of this supplemental opinion.

This letter, which should be read together with the ISDA Netting Opinion, is addressed to ISDA solely for the benefit of its members in relation to their use of the ISDA Master Agreements. No other person may rely on this letter for any purpose without prior written consent. This letter may, however, be shown by an ISDA member to a competent regulatory or supervisory authority or professional advisers for such ISDA member for the purposes of information only, on the basis that we assume no responsibility to such authority, advisor or to any other person as a result, or otherwise.

Yours faithfully

Allen & Overy LLP

Allen & Overy LLP

Revised form of
APPENDIX B (September 2009) to the ISDA Netting Opinion

CERTAIN COUNTERPARTY TYPES[10]

Description	Covered[11]	Legal form(s)[12]
Bank/Credit Institution. A legal entity, which may be organized as a corporation, partnership or in some other form, that conducts commercial banking activities, that is, whose core business typically involves (a) taking deposits from private individuals and/or corporate entities and (b) making loans to private individual and/or corporate borrowers. This type of entity is sometimes referred to as a "commercial bank" or, if its business also includes investment banking and trading activities, a "universal bank". (If the entity only conducts investment banking and trading activities, then it falls within the "Investment Firm/Broker Dealer" category below.) This type of entity is referred to as a "credit institution" in European Community (**EC**) legislation. This category may include specialised types of bank, such as a mortgage savings bank (provided that the relevant entity accepts deposits and makes loans), or such an entity may be considered in the local jurisdiction to constitute a separate category of legal entity (as in the case of a building society in the United Kingdom (**UK**)).	Yes[13]	English Company[14]

10 In these definitions, the term "legal entity" means an entity with legal personality other than a private individual.

11 This column indicates whether an entity of the relevant type falls within the scope of this memorandum. Where the answer is "No", this is due to the fact that to include this type of entity would require substantial additional legal analysis, beyond the scope of our current instructions.

12 This column indicates the legal form in which an entity of the relevant type is typically organised in England under English law. While it is possible, in some cases, that an entity falling within the commercial description in the left-hand column could organised in a different legal form in England, any such entity would not fall within the scope of this memorandum, unless expressly provided to the contrary. For example, an Investment Firm organised as a limited liability partnership is not within the scope of this memorandum. A capitalised term used in this column has, unless context indicates otherwise, the meaning given to that term in this memorandum.

13 Sections 58(1) and 59(1) of the Companies Act 2006, respectively. In the case of a Company with its registered office in Wales, the name of the Company may end with the Welsh equivalents of these terms.

14 There are various forms of English Company, including a public limited company, a private company with limited liability, a private company with unlimited liability and a private company limited by guarantee. Our conclusions in this memorandum apply to each type of English Company. The naming conventions for English Companies are set out in sections 58(1) and 59(1) of the Companies Act 2006. An English Company that is a public limited company must have a name that ends with the words "public limited company" or the abbreviation "plc". A private company with limited liability or limited by guarantee must have a name ending with the word "Limited" or the abbreviation "ltd". In either case, the abbreviation may be all upper case, all lower case, with an initial upper case letter only and with or without full stops between the letters (in the case of "plc"). A private company with unlimited liability is not required to have any specific word or abbreviation at the end of its name. In the case of a company registered under the Companies Act 2006 with its registered office in Wales, the name of the company may end with the Welsh equivalents of these terms.

Description	**Covered**[11]	**Legal form(s)**[12]
Central Bank. A legal entity that performs the function of a central bank for a Sovereign or for an area of monetary union (as in the case of the European Central Bank in respect of the euro zone).	Yes, but only in relation to the Central Bank of the United Kingdom	Chartered Corporation
Corporation. A legal entity that is organized as a corporation or company rather than a partnership, is engaged in industrial and/or commercial activities and does not fall within one of the other categories in this Appendix B.	Yes	English Company
Hedge Fund/Proprietary Trader. A legal entity, which may be organized as a corporation, partnership or in some other legal form, the principal business of which is to deal in and/or manage securities and/or other financial instruments and/or otherwise to carry on an investment business predominantly or exclusively as principal for its own account.	Yes	English Company
Insurance Company. A legal entity, which may be organised as a corporation, partnership or in some other legal form (for example, a friendly society or industrial & provident society in the UK), that is licensed to carry on insurance business, and is typically subject to a special regulatory regime and a special insolvency regime in order to protect the interests of policyholders.	Yes	English Company, Friendly Society, I&P Society, Statutory Corporation, Chartered Corporation
International Organization. An organization of Sovereigns established by treaty entered into between the Sovereigns, including the International Bank for Reconstruction and Development (the World Bank), regional development banks and similar organizations established by treaty.	No	

Description	Covered[11]	Legal form(s)[12]
Investment Firm/Broker Dealer. A legal entity, which may be organized as a corporation, partnership or in some other form, that does not conduct commercial banking activities but deals in and/or manages securities and/or other financial instruments as an agent for third parties. It may also conduct such activities as principal (but if it does so exclusively as principal, then it most likely falls within the "Hedge Fund/Proprietary Trader" category above.) Its business normally includes holding securities and/or other financial instruments for third parties and operating related cash accounts. This type of entity is referred to as a "broker-dealer" in US legislation and as an "investment firm" in EC legislation.	Yes	English Company
Investment Fund. A legal entity or an arrangement without legal personality (for example, a common law trust) established to provide investors with a share in profits or income arising from property acquired, held, managed or disposed of by the manager(s) of the legal entity or arrangement or a right to payment determined by reference to such profits or income. This type of entity or arrangement is referred to as a "collective investment scheme" in EC legislation. It may be regulated or unregulated. It is typically administered by one or more persons (who may be private individuals and/or corporate entities) who have various rights and obligations governed by general law and/or, typically in the case of regulated Investment Funds, financial services legislation. Where the arrangement does not have separate legal personality, one or more representatives of the Investment Fund (for example, a trustee of a unit trust) contract on behalf of the Investment Fund, are owed the rights and owe the obligations provided for in the contract and are entitled to be indemnified out of the assets comprised in the arrangement.	Yes	Open-Ended Investment Company, Authorised Unit Trust (acting through its Trustee)
Local Authority. A legal entity established to administer the functions of local government in a particular region within a Sovereign or State of a Federal Sovereign, for example, a city, county, borough or similar area.	No	

Description	**Covered**[11]	**Legal form(s)**[12]
Partnership. A legal entity or form of arrangement without legal personality that is (a) organised as a general, limited or some other form of partnership and (b) does not fall within one of the other categories in this Appendix B. If it does not have legal personality, it may nonetheless be treated as though it were a legal person for certain purposes (for example, for insolvency purposes) and not for other purposes (for example, tax or personal liability).	No	
Pension Fund. A legal entity or an arrangement without legal personality (for example, a common law trust) established to provide pension benefits to a specific class of beneficiaries, normally sponsored by an employer or group of employers. It is typically administered by one or more persons (who may be private individuals and/or corporate entities) who have various rights and obligations governed by pensions legislation. Where the arrangement does not have separate legal personality, one or more representatives of the Pension Fund (for example, a trustee of a pension scheme in the form of a common law trust) contract on behalf of the Pension Fund and are owed the rights and owe the obligations provided for in the contract and are entitled to be indemnified out of the assets comprised in the arrangement.	No	
Sovereign. A sovereign nation state recognized internationally as such, typically acting through a direct agency or instrumentality of the central government without separate legal personality, for example, the ministry of finance, treasury or national debt office. This category does not include a State of a Federal Sovereign or other political sub-division of a sovereign nation state if the sub-division has separate legal personality (for example, a Local Authority) and it does not include any legal entity owned by a sovereign nation state (see "Sovereign-owned Entity").	Yes, but only in relation to the United Kingdom acting through Her Majesty's Treasury	

Description	Covered[11]	Legal form(s)[12]
Sovereign Wealth Fund. A legal entity, often created by a special statute and normally wholly owned by a Sovereign, established to manage assets of or on behalf of the Sovereign, which may or may not hold those assets in its own name. Such an entity is often referred to as an "investment authority". For certain Sovereigns, this function is performed by the Central Bank, however for purposes of this Appendix B the term "Sovereign Wealth Fund" excludes a Central Bank.	No	
Sovereign-Owned Entity. A legal entity wholly or majority-owned by a Sovereign, other than a Central Bank, or by a State of a Federal Sovereign, which may or may not benefit from any immunity enjoyed by the Sovereign or State of a Federal Sovereign from legal proceedings or execution against its assets. This category may include entities active entirely in the private sector without any specific public duties or public sector mission as well as statutory bodies with public duties (for example, a statutory body charged with regulatory responsibility over a sector of the domestic economy). This category does not include local governmental authorities (see "Local Authority").	No	
State of a Federal Sovereign. The principal political sub-division of a federal Sovereign, such as Australia (for example, Queensland), Canada (for example, Ontario), Germany (for example, Nordrhein-Westfalen) or the United States of America (for example, Pennsylvania). This category does not include a Local Authority.	No	
Standard Chartered Bank	Yes	Chartered Corporation
English Trust	Yes	English Trust (acting through its Trustee(s))
English Charity	Yes	English Charitable Trust (acting through its Trustee(s)), English Company, Friendly Society, I&P Society, Statutory Corporation, Chartered Corporation
Friendly Society	Yes	Friendly Society
I&P Society	Yes	I&P Society

Description	**Covered**[11]	**Legal form(s)**[12]
Statutory Corporation	Yes	Statutory Corporation
Chartered Corporation	Yes	Chartered Corporation

RECOURSE TO THE ASSETS OF A TRUST

1. A Trustee's right of recourse to the assets of a trust

A Trustee has statutory[15] and general trust law rights of indemnity[16] against a trust for all expenses, and general trust law rights in respect of all liabilities that it incurs in the course of carrying out its duties. The general trust law right of indemnity is a form of equitable charge and is also known as the Trustee's lien. There may also be an express right of indemnity of the Trustee against the trust assets under the trust deed.[17]

A third party dealing with a Trustee does not have a general non-contractual right of enforcement against the trust assets under statute or common law. There may be an express or implied direct right of recourse for third parties under the trust deed. This is discussed in 2 below. A third party will, however, be subrogated to the Trustee's right of indemnity, but will therefore be vulnerable to any impairment of that right of indemnity as discussed further below.

Should a Trustee need to use trust assets to fulfil a contractual obligation to a third party, the Trustee's exercise of the right of recourse against the trust is subject to the following limitations arising under general equitable principles:

(a) the Trustee must have acted within its powers, that is to say it must have been empowered by statute and by the relevant trust deed to undertake the Transaction in question;

(b) the Trustee must have exercised those powers prudently for the purpose for which they were conferred and in the interests of the beneficiaries of the trust;

(c) the Trustee must have taken all relevant considerations into account and no irrelevant considerations; and

(d) the Trustee must have complied with any internal authorisation and other relevant requirements of the trust as set out in the trust deed.

An important risk when dealing with a Trustee is that the Trustee's right to reimbursement from the trust's assets has been impaired by a breach of trust that is entirely unrelated to the liability for which it is seeking reimbursement. The general principle is that a Trustee may not claim reimbursement from the trust assets to satisfy a contractual liability where it has committed a breach of trust and failed to rectify the breach, assuming it is capable of rectification, regardless of whether the breach was related to the incurring of the liability and even if the breach occurred after the liability was incurred. Impairment of the Trustee's right of recourse will, therefore, be a continuing risk for any creditor, even if the Transaction giving rise to its claim against the Trustee has been properly entered into.

The fragility of the Trustee's right of recourse to the trust is a serious difficulty for a commercial counterparty wishing to deal with a Trustee. It was partly in recognition of this problem that the

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15 Trustee Act 2000.

16 The terms "right of recourse, "right of indemnity" and "right of reimbursement" are more or less interchangeable in this context, and used as such in this Appendix II.

17 In this Appendix II we use the term "trust deed" for convenience, given that the principal document constituting a trust is normally executed as a deed. We use the term, however, to refer to all the documentation governing the operation of the trust (whether or not executed by deed), including the duties, obligations and rights of the Trustee(s) and the rights of the beneficiaries, whether set out in the trust deed itself or in a related document made pursuant to the trust deed (for example, a document setting out rules for the trust).

Trust Law Committee, discussed further below, was founded.[18] One of the principal aims of the Trust Law Committee has been to consider appropriate law reform measures to make trusts more suitable for use in modern commercial practice. Unfortunately, the difficulty posed by an unrelated breach of trust remains an issue for creditors of Trustees.

2. A third party's right of recourse to the assets of a trust

To protect against the risk that the Trustee's right of recourse has been lost or impaired, or where this has happened, a third party may wish to consider the following:

2.1 In circumstances where the third party has enriched or benefited the Trust at its own expense, and it was acting in good faith and did not know that the Trustee was acting beyond its powers, it is possible that the third party may have a direct non-derivative claim in equity, based in the law of restitution, against the trust assets, even in circumstances where the Trustee has exceeded its powers.[19]

The possibility of such a restitution-based claim is referred to in a consultation paper dated April 1997 published by the Trust Law Committee (the **1997 Consultation Paper**). However, we should point out that the precise scope of this claim is still not entirely clear as a matter of English law. The claim would be limited to the extent that the Trust is benefited and may be affected by the defence of change of position, and so we would not recommend that a party rely on the availability of such a claim.

2.2 A provision may be added to the ISDA Master Agreement under which the Trustee creates a contractual right for the other party to have direct recourse to the assets of the trust to the extent of the Trustee's liability under the ISDA Master Agreement. If valid, this right would be analogous to the Trustee's own right of recourse, without being subject to the limitations as set out in 1 above, and would take priority over the Trustee's right to enforce its indemnity against the trust assets. For such a provision to be effective, the trust deed would need to anticipate and give the Trustee authorisation to confer this direct right of recourse on a third party.

The Trust Law Committee in the 1997 Consultation Paper cites the cases of *ex parte Garland*[20] and *Fairland v Percy*[21] as authority for the proposition that such a direct right of recourse will be effective where the trust instrument anticipates and gives the Trustee authorisation to confer this direct right of recourse. Although these cases are not directly on point, we believe that the better view is that a Trustee can be authorised by the trust deed to confer on a counterparty by contract a direct right of recourse that is analogous to the Trustee's own right of recourse but which is not subject to the same limitations and which takes priority over the Trustee's own lien. We note that the Trust Law Committee was firmly of this view in the 1997 Consultation Paper, although it did not cite any case law that was directly on point or any other authoritative commentary in the 1997 Consultation Paper.

In the 1997 Consultation Paper, the Trust Law Committee suggested that it may be possible for the contract between the Trustee and a third party to give the third party a direct right of recourse to the trust assets even if the trust deed does not expressly authorise the Trustee to confer such a direct right of recourse, provided that there was nothing in the trust deed which expressly prevented such a right of recourse being given. However, the Trust Law Committee noted that there is no English case law authority to support such a proposition, and we are not aware of any more recent cases that have supported the suggestion in the 1997 Consultation Paper.

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18 The Trust Law Committee is an *ad hoc* group of leading academics and practitioners dedicated to researching weaknesses of English trust law and ways of improving it. The Trust Law Committee is run under the charitable auspices of King's College London. Further information may be found at <http://www.kcl.ac.uk/law/research/centres/trustlawcommittee/index.aspx> accessed 9 May 2012.

19 *Devaynes v Robinson* (1857) 24 Beav 86.

20 (1804) 10 Ves 110.

21 (1875) LR 3 P&D 217.

The 1997 Consultation Paper was followed in June 1999 by the Trust Law Committee's Report on the Rights of Creditors Against Trustees and Trust Funds (the **1999 Report**). In the 1999 Report, the Trust Law Committee recommended that legislation be passed to the effect that any indebtedness of a Trustee to the trust fund (for example, by reason of breach of trust) should not prevent a creditor from having a right of indemnity out of the trust fund if the Trustee's breach was not connected with the contract with the creditor. However, this proposal was never adopted. In the 1999 Report, the Trust Law Committee repeated its view that, even absent an express power in the trust instrument, an English court may reach the conclusion that a Trustee was able to give a creditor a direct right of indemnity by way of an unsecured right of recourse to the trust fund absent any provision to the contrary in the trust instrument. However, as mentioned above, this is by no means certain and is not yet, as far as we are aware, supported by any English case.

ANNEX 1

TRUSTEE OF AN ENGLISH TRUST

In this Annex 1, we set out our views on the enforceability of the close-out netting provisions of the ISDA Master Agreement against a Trustee of an English Trust in the event that insolvency proceedings are commenced in England in respect of the Trustee or the English Trust is wound up.

In this Annex 1, as noted in part 3(a) of this supplemental opinion, we only consider an English Trust that is not an English Charitable Trust, Authorised Unit Trust or other form of trust subject to a special regulatory regime, such as an occupational pension scheme. In Annex 8 we consider how the principles below apply in the case of a Trustee of an English Charitable Trust. In Annex 10 we consider how the principles below apply in the case of a Trustee of an Authorised Unit Trust. As noted in part 2.1(d) of this supplemental opinion, any other form of English Trust that is subject to a special regulatory regime that may affect the enforceability of close-out netting under the ISDA Master Agreement is beyond the scope of this supplemental opinion.

Subject to the more detailed discussion below, the types of insolvency proceeding that may be commenced in England in respect of a Trustee are the same as those that would apply in respect of an English Company, as described in part III.1(4) of the ISDA Netting Opinion, since we have assumed in part 2.1 of this supplemental opinion that the Trustee is an English Company.

If the English Trust itself (rather than the Trustee) were to become insolvent, the English Trust would not be wound up under English insolvency legislation as it is not a legal person. Instead, the following possibilities exist:

(i) the Trustees could wind up the English Trust in various circumstances, provided that the trust deed confers this power on the Trustees and the relevant circumstances have occurred; and

(ii) the court could make an administration order[22] in relation to the English Trust under Rule 64.2 of the Civil Procedure Rules 1998.

Under Rule 64.2 of the Civil Procedure Rules 1998, the execution of the English Trust would be carried out under the direction of the court. The court would only make an administration order if it considered that the issues between the parties could not properly be resolved in any other way.

1. Conclusion

On the basis of the assumptions and subject to the qualifications in part III of the ISDA Netting Opinion as modified and supplemented by this supplemental opinion, including this Annex 1, we are of the view that our conclusions in part III.3 of the ISDA Netting Opinion would apply to a Trustee of an English Trust in the event that insolvency proceedings are commenced in England in respect of the Trustee or a Trust Insolvency (as defined below) occurs.

[22] Referred to as an "administration order" under this Rule, but not to be confused with an administration order under Part II of the Insolvency Act 1986.

2. Analysis

We consider below the enforceability of the close-out netting provisions of the ISDA Master Agreement in the following three cases:

(I) where there is more than one Trustee and insolvency proceedings are commenced in England in respect of at least one Trustee but one or more solvent Trustees remain (a **Partial Trustee Insolvency**);

(II) where there is a single Trustee and insolvency proceedings are commenced in England in respect of it or there is more than one Trustee and insolvency proceedings are commenced in England in respect of each Trustee (a **Full Trustee Insolvency**); and

(III) where the English Trust is insolvent, in the sense that the assets held on trust are insufficient to meet the liabilities incurred by the Trustees on behalf of the English Trust (a **Trust Insolvency**).

2.1 *Partial Trustee Insolvency*

A Partial Trustee Insolvency would normally fall within the Section 5(a)(vii) (Bankruptcy) Event of Default in the ISDA Master Agreement. A party to an ISDA Master Agreement with an insolvent Trustee may not, however, wish to exercise its right to designate an Early Termination Date in relation to the Trustee for the following reasons:

(a) on a Partial Trustee Insolvency, on the assumption that all the Trustees would be jointly and severally liable for the obligations under the ISDA Master Agreement, a party would be entitled to proceed against any of the remaining Trustees who would have recourse to the assets of the English Trust to meet that liability (regarding which, see Appendix II); and

(b) a Partial Trustee Insolvency would not affect the enforceability of the close-out netting provisions of the ISDA Master Agreement against each remaining solvent Trustee, as confirmed in part 4 of this supplemental opinion, or interfere with the direct recourse of any such Trustee to the assets of the English Trust to satisfy its obligations under the ISDA Master Agreement, subject to the discussion in Appendix II.

2.2 *Full Trustee Insolvency*

A Full Trustee Insolvency (like a Partial Trustee Insolvency) would normally fall within the Section 5(a)(vii) (Bankruptcy) Event of Default in the ISDA Master Agreement.

We believe that it is unlikely that an English Trust would be left without any solvent Trustees. In other words, under normal circumstances it is unlikely that a Full Trustee Insolvency would occur and persist for a significant period of time.[23] Where there is more than one Trustee, it is unlikely that all of the Trustees would be simultaneously insolvent.

Where there is a sole Trustee which becomes insolvent, the trust deed would normally provide that a person identified in the trust deed may select a new Trustee, and the court has a statutory power to appoint a new Trustee subject to certain conditions specified by statute.[24] Following such substitution, a party, by subrogation to the original Trustee's right of indemnity, would be entitled to enforce its subrogated right of indemnity against the trust assets directly, regardless of the fact that the newly-appointed Trustee would not be liable for the previous Trustee's liabilities. As such right

[23] Although this risk is increased if there is a single Trustee.
[24] Section 41 of the Trustee Act 1925.

would arise by subrogation to the right of the original Trustee, it would be limited to the extent of the original Trustee's right of indemnity, which may have been lost or limited by breach of trust by that Trustee, as discussed in Appendix II.

A party may agree with the new Trustee and the previous Trustee a novation of the previous Trustee's rights and obligations under the ISDA Master Agreement to the new Trustee. In this case, a party will be dealing with the new Trustee (and relying on the new Trustee's recourse to the trust assets) rather than seeking to enforce its subrogated right of indemnity by virtue of the previous Trustee's right of indemnity.

On the assumption that the English Trust is solvent, an insolvent Trustee (and a third party by subrogation) will still be able to enforce its claim against the trust assets, provided the Trustee has not lost its right of recourse in one of the ways described in Appendix II. In any event, as mentioned above, we believe that a Full Trustee Insolvency would normally be unlikely to occur and endure for a significant period of time as a matter of practice.

If, however, a Full Trustee Insolvency were to occur, we believe that the ISDA Master Agreement and all Transactions entered into between a party and the Trustee would be considered as a single agreement between the party and the Trustee. For the reasons given in part III.3(3)(a) of the ISDA Netting Opinion, we believe that an English court would construe the close-out netting provisions of the ISDA Master Agreement as not involving contractual set-off (other than to the limited extent that it includes Unpaid Amounts due from the Defaulting Party, as discussed in the ISDA Netting Opinion) but simply as representing an accounting of rights and liabilities under a single agreement following the designation or deemed occurrence of an Early Termination Date in the event of a Full Trustee Insolvency. As noted in the ISDA Netting Opinion, this is sometimes referred to as the "flawed asset" approach to contractual netting.

If, however, the court were to construe the close-out netting provisions of the ISDA Master Agreement as operating by way of contractual set-off rather than pursuant to the single agreement (or "flawed asset") approach discussed above, we also consider that the close-out netting provisions of the ISDA Master Agreement would be enforceable against each Trustee in a Full Trustee Insolvency under English law. Our reasons for this view are principally those set out in part III.3(3)(a) of the ISDA Netting Opinion. In relation to netting against a Trustee, however, there is an additional issue that must be considered.

Insolvency set-off under Rule 2.85 of the Insolvency Rules 1986, in the event of administration proceedings, or Rule 4.90 of the Insolvency Rules 1986, in the event of winding up proceedings, is limited to mutual obligations. This gives rise to a technical issue when a Trustee enters into any contract on behalf of an English Trust, even if the Trustee is acting within its powers when entering into the contract, as there is an argument that there are no mutual obligations between a Trustee and its contracting party under the contract.

The argument runs as follows: the Trustee is not beneficially entitled to any obligations owed by the other party as the benefit of such obligations are owned by the beneficiaries of the English Trust. However, the contractual obligations are owed by the Trustee (because it is a party to the contract) and the Trustee is therefore liable in its personal capacity even though the contract is for the benefit of the English Trust.

It was acknowledged by the Trust Law Committee in the 1997 Consultation Paper that, if it is correct that the foregoing constitutes a lack of mutuality barring insolvency set-off, then this position is most unsatisfactory for the Trustee and its contracting party. We do not believe, however, that this position is correct for the reasons given below.

In relation to an ISDA Master Agreement, the purported lack of mutuality will not be an issue prior to an administration or liquidation of the Trustee as the ISDA Master Agreement between the Trustee and the other party will take effect according to its terms, given our assumptions as to legal capacity and due authorisation of each of the parties. However, this issue could arise in the event of the administration or liquidation of the Trustee as the insolvency set-off rules (if they apply in the absence of the "flawed asset" characterisation being accepted) will override any contractual provisions that are inconsistent with those rules.

2.3 *Arguments in favour of mutuality*

Given the strong policy in favour of insolvency set-off in English law, we think that in a Full Trustee Insolvency the obligations owed by each Trustee to the other party under an ISDA Master Agreement and the obligations owed by the other party to the Trustee for the benefit of the English Trust would be treated as mutual notwithstanding the technical argument that the respective obligations are not mutual because each Trustee is personally liable for the obligations it owes but not beneficially entitled to the obligations it is owed for the benefit of the English Trust.

Notwithstanding the technical argument, the Trustee has incurred its obligations solely for the purposes of the English Trust and, subject to the issues discussed in Appendix II, it is entitled to indemnification out of the assets of the English Trust. Any obligations of the other party are owed to the Trustee, but solely for the benefit of the English Trust. Substantively, therefore, there is mutuality at the level of the English Trust. All amounts owed by and to a Trustee for purposes of the English Trust should therefore, in our view, be considered mutual for the purposes of insolvency set-off against the Trustee.

The Trust Law Committee, in the 1997 Consultation Paper and the 1999 Report, suggested that, on a Trust Insolvency where an application to court was made under Rule 64.2 of the Civil Procedure Rules, the court might treat the English Trust as a "quasi-person" involved in bilateral mutual dealings with a counterparty and would apply similar insolvency set-off rules to those that would apply if the trust fund were an individual or a company. This would be particularly relevant where, as would typically be the case, the Trustee has limited its liability under the ISDA Master Agreement to the value of the trust assets and the other party's remedies are therefore limited to its indirect right of recourse (by subrogation to the Trustee's right of recourse) to the trust assets (in other words to the insolvent trust fund).

Furthermore, if the Trustee becomes insolvent, provided that the Trustee has not lost its right of indemnity in one of the ways described in Appendix II, the Trustee will still have recourse to the trust fund in relation to any obligations owed by it under the ISDA Master Agreement, secured by its Trustee's lien, and so will have a beneficial interest in the English Trust to the extent of this right of recourse. There is an argument that this would give the Trustee a beneficial interest in the trust fund (including the benefit of the obligations owed by the counterparty) such that the Trustee could be described as being beneficially entitled to the other party's obligations, thereby establishing mutuality (although we note that the Trust Law Committee, in the 1997 Consultation Paper, was not convinced that this argument would be successful).

The other party may also have a direct right of recourse to the trust assets (subject to the qualifications referred to above), particularly if the ISDA Master Agreement provides that the other party's right of recourse is to the trust assets rather than to the Trustee in its personal capacity. Such a right of recourse may mean that the English court would allow set-off between the other party and the trust fund on this basis.

The foregoing are essential technical arguments to rebut technical objections based on a characterisation of mutuality for set-off purposes as requiring personal liability and beneficial entitlement to be united in the same person acting in the same capacity in relation to each liability and entitlement. However, the policy which underlies the principle of mutuality in relation to set-off is that one person's assets should not be used to satisfy another person's creditors.

Accordingly, the formulation of the mutuality requirement narrowly in terms of personal liability and beneficial entitlement is, in our view, not appropriate to claims where a Trustee is attempting to set off claims owed to the Trustee for the benefit of the English Trust against claims owed by the Trustee that were incurred on behalf of the same trust. In other words, this analysis of mutuality does not take into account the special nature of an English Trust under English law. While the purpose of the English Trust is, among other things, to permit a separation of legal ownership and beneficial ownership, nonetheless many rules of trust law are based upon an identification of the interests of a Trustee with those of the beneficiaries for a variety of purposes. In the case of set-off, permitting an obligation owed to the Trustee (which is a trust asset) to be discharged by set-off of a liability of the Trustee incurred legitimately for the benefit of the English Trust manifestly does not offend against the policy of not permitting one person's asset (the trust asset) being used to discharge another person's liability (the Trustee's liability on behalf of the English Trust). This is because the Trustee's liability is only "personal" in the sense that, as a technical matter, a creditor may not proceed against the beneficiaries directly (other than in exceptional circumstances not relevant to the facts you have asked us to assume).[25] But it is a special type of liability which, as a matter of trust law, carries with it a special right, namely, the right of recourse to the assets of the English Trust in priority to the rights of the beneficiaries.

On the other hand, an English court would clearly not permit an obligation owed to a Trustee for the benefit of the trust fund to be set-off against a purely personal liability of the Trustee (that is, one incurred solely for its own benefit). Clearly this latter case would offend against the policy mentioned above. Therefore, notwithstanding the lack of direct case law support for the proposition, we believe that an English court is highly likely to view obligations owed to a Trustee for the benefit of an English Trust as mutual with obligations owed by the Trustee that were legitimately incurred for the benefit of the English Trust and therefore to permit insolvency set-off of such obligations, whether in the case of a Full Trustee Insolvency or a Trust Insolvency.

We therefore consider that the strong weight of informed opinion supports the view that there would be sufficient mutuality between the respective obligations for a right of set-off to be available on a liquidation of the Trustee or an insolvency of the trust fund, although there is no case law to support this view. If the court were to treat the respective obligations as mutual, Section 6(e) of the ISDA Master Agreement should work even on the basis of an insolvency set-off analysis. In any event, however, as stated above we think that the English courts would be likely to accept the single agreement nature of the relevant ISDA Master Agreement. The mutuality issue would only be relevant to the argument that the close-out netting provisions of the ISDA Master Agreement would also be effective under a set-off analysis.

2.4 *Trust Insolvency*

As noted above, as an English Trust is not a legal person, it is not subject to the insolvency legislation of the type that applies to legal persons.[26] An English Trust may, however, be wound up, if the trust deed so provides and any relevant conditions or requirements of the trust deed are satisfied. It is also possible for the court to make an administration order in relation to the English Trust under Rule 64.2 of the Civil Procedure Rules 1998, under which the administration of the English Trust will be carried out by court.

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25 See, for example, *Hardoon v Belilios* [1901] AC 118 (PC).

26 See, for example, *Gilbert Deya Ministries v Kashmir Broadcasting Corporation Ltd* [2010] EWHC 3015 (Ch), where the court held that an charitable trust is not an unregistered company for purposes of Part V of the Insolvency Act 1986, which provides for the winding up of unregistered companies. The same would be true of any trust, whether or not established for charitable purposes.

Usually an English Trust, particularly if it is solvent, will be wound up by its Trustees, rather than by the court, in accordance with the terms of the trust deed. This may be on a solvent or an insolvent basis. This type of winding up is not under the supervision of the court.

There are no mandatory set-off rules that apply if an English Trust is wound up (i) in accordance with its trust deed or (ii) under an administration order made under Rule 64.2 of the Civil Procedure Rules 1998. In the latter case it is possible that the court would apply the same mandatory insolvency set-off rules that would have applied if the English Trust were a legal person (that is, a natural person subject to section 323 of the Insolvency Act 1986 or a Companies Act Company subject to Rule 2.85 or Rule 4.90 of the Insolvency Rules 1986). To the extent a mandatory set-off rule is applied, we believe that the close-out netting provisions of the ISDA Master Agreement would be enforceable to the same extent on a Trust Insolvency as on a Full Trustee Insolvency.

As in the case of a Full Trustee Insolvency, the technical issue may be raised that there is insufficient mutuality between the creditor and the English Trust (viewed, in effect, as a "quasi-person" for purposes of the winding up) for a right of insolvency set-off to apply in these circumstances. However, we believe that an English court would find that there was mutuality for this purpose for the reasons set out in 2.3 above.

If the court did make an order under Rule 64.2, it has broad discretion, as there is no provision in the Civil Procedure Rules 1998 directing how the court should direct the execution of the English Trust. However, the Trust Law Committee in the 1997 Consultation Paper suggests that the court would divide the assets of the insolvent trust in the following priority: (i) secured creditors; (ii) costs of realisation of assets; (iii) preferential creditors; and (iv) floating charges in the order of creation.[27] After that it is uncertain what the court would direct, though it is clear that a creditor with an indirect claim on the trust assets by way of subrogation to a Trustee's right of reimbursement would be limited to the sum that such Trustee could claim.

In relation to an English Trust, it is possible for the trust deed to contain a provision stating that a certain event will trigger the winding up of the English Trust or providing that one or more persons (for example, the person who created the English Trust, usually referred to as the "grantor" or "settlor" of the English Trust) to have the right to trigger a winding up of the English Trust under the trust deed. In either case or under any other provision of the trust deed requiring or permitting the winding up of the Trust, it would normally be the Trustees who carry out the winding up.

When an English Trust were wound up, the assets of the English Trust would be applied to satisfy the liabilities validly incurred by the Trustees on behalf of the English Trust. If there were insufficient assets to cover the entirety of those liabilities, we believe that the assets would be applied in the priority order suggested by the Trust Law Committee in the 1997 Consultation Paper as discussed above.

Provided the Trustee's right of recourse to the trust assets is not impaired as discussed in Appendix II, then it will have a right of recourse to the trust assets secured by its lien that will enable the Trustee to use the assets of the English Trust to pay creditors in priority to the beneficiaries. In other words, the rights of the beneficiaries of an English Trust are subordinate to the Trustee's right of recourse.

[27] We note that in the 1999 report, the Trust Law Committee states that it seems likely that the priority order that the court would lay down would be (1) creditors with fixed charges, (2) creditors with floating charges, (3) preferential creditors, (4) general creditors. No explanation is given for the change of the position of preferential creditors and creditors with floating charges between the 1997 Consultation Paper and the 1999 Report. Given that the position in the 1997 Consultation Paper reflects the priority position on the winding up of a company, and that there is no explanation for the change, we believe the true view of the Trust Law Committee is that set out in the 1997 Consultation Paper.

2.5 *Avoidance of Transactions – Partial Trustee Insolvency or Full Trustee Insolvency*

The Insolvency Act 1986 gives the court, subject to certain conditions, the power to avoid certain contracts or other transactions between a party and an entity subject to winding up or administration under the Insolvency Act 1986. For present purposes, the relevant provisions are section 238 (transactions at an undervalue), section 239 (preferences) and section 423 (transactions defrauding creditors). Either of these provision could apply in the event of a Partial Trustee Insolvency or Full Trustee Insolvency.

These provisions are discussed in more detail in the ISDA Netting Opinion. As a general rule, none of these provisions will apply provided that the ISDA Master Agreement and each Transaction between a party and the insolvent Trustee were entered into by each of the party and the Trustee in good faith and at arm's length.

2.6 *Avoidance of Transactions – Trust Insolvency*

The court has a general equitable power to avoid a transaction by virtue of which a debtor apparently treats one creditor preferentially relative to other creditors, where the creditor enjoying the preference knows at the time of the transaction that the debtor is in financial difficulties.[28]

While this jurisprudence is considered to have been displaced by the specific provisions of the Insolvency Act 1986 in relation to corporate insolvencies, it might still apply in relation to a non-corporate insolvency, such as the winding up of an English Trust. It is important to note that, in these circumstances, there is no specific time period, but rather a general vulnerability of transactions entered into where the relevant creditor knows (or should have known) that the debtor is in financial difficulty.

We consider it unlikely that the court would make an order of this type merely because a creditor dealt with an English Trust that was under-funded. We would suggest that something more would be required, similar to the requirements of section 239 of the Insolvency Act 1986 (which deals with preferences in relation to a corporate insolvency), namely, that there was an active intention of the debtor to put the creditor in a better position than other creditors in the event of its winding-up. Normally a transaction entered into at arm's-length where value is given and received contemporaneously (as opposed to consideration for a pre-existing debt, for example) will not be preferential in this sense.

There is the possibility that a creditor of the Trustees could seek an order under section 423 of the Insolvency Act 1986 (transactions defrauding creditors) as this provision, notwithstanding the fact that it appears in the Insolvency Act 1986, may be invoked even where there are no insolvency proceedings under the Insolvency Act 1986. Also this provision, which is the latest incarnation of a very old rule against fraudulent conveyances, is available to any creditor of any person (not limited to companies) who has been defrauded by entry into a transaction at any undervalue by that person with a third person. There is no time limit on the application of this provision, so in theory the court could reopen and avoid a transaction entered into years ago (although in practice the older a transaction is the less likely the court is to do so). The definition of "transaction at an undervalue" is similar to the one used in section 238 of the Insolvency Act 1986 and is set out in the ISDA Netting Opinion. A market counterparty acting in good faith who has given value will have a defence to such an order being granted.

It is possible that the English Trust could be subject to an administration order, as already mentioned above. In these circumstances, section 423 of the Insolvency Act 1986 and the old jurisprudence mentioned above relating to preferences would be relevant, the same considerations as described

[28] *Watts v Christie* (1849) 11 Beav 546, 50 ER 928.

above applying, including no time limit in the former case and an indefinite time period in the latter case running from knowledge by the creditor of the debtor's financial difficulties.

ANNEX 2

FRIENDLY SOCIETY

In this Annex 2, we set out our views on the enforceability of the close-out netting provisions of the ISDA Master Agreement against a Friendly Society in the event that insolvency proceedings are commenced in England in respect of the Friendly Society. In this Annex 2 we consider only a Friendly Society that is neither an English Insurance Company nor an English Charity nor otherwise subject to a special regulatory regime. In Annex 6 we consider a Friendly Society that is an Insurance Company, and in Annex 8 we consider a Friendly Society that is an English Charity.

Subject to the more detailed discussion below, the types of insolvency proceeding that may be commenced in England in respect of a Friendly Society are, pursuant to section 21 or 22 of the Friendly Societies Act 1992, a voluntary or compulsory winding up under the Insolvency Act 1986. It is also possible that a Friendly Society could be made subject to a scheme of arrangment under Part 26 of the Companies Act 2006.

1. Conclusion

On the basis of the assumptions and subject to the qualifications in part III of the ISDA Netting Opinion as modified and supplemented by this supplemental opinion, including this Annex 2, we are of the view that our conclusions in part III.3 of the ISDA Netting Opinion would apply to a Friendly Society in the event that insolvency proceedings are commenced in England in respect of the Friendly Society.

2. Analysis

2.1 *Insolvency proceedings in respect of a Friendly Society*

Section 21 and 22 of the Friendly Societies Act 1992 provide that a Friendly Society may be wound up voluntarily (that is, by the creditors) or compulsorily (that is, by the court). Section 23 provides that "the companies winding up legislation" specified in paragraph 1 of Schedule 10 to the Friendly Societies Act 1992 shall apply, as modified by Parts I and II of Schedule 10. The winding up legislation specified in paragraph 1 of Schedule 10 consists of Parts IV, VI, VII, XII and XIII of the Insolvency Act 1986.

These provisions, as modified by the Friendly Societies Act 1992, apply the companies winding up provisions to Friendly Societies, but not the company voluntary arrangement provisions in Part I or the administration provisions in Part II of the Insolvency Act 1986. Section 255 of the Enterprise Act 2002 provides the Treasury with the power to provide by order for an administration regime for Friendly Societies. To date, no such order has been made by the Treasury.

It is unclear what insolvency rules would apply to a winding up of a Friendly Society. Paragraph 69 of Schedule 10 to the Friendly Societies Act 1992 provides that rules may be made under section 411 of the Insolvency Act 1986 for the purpose of giving effect to winding up legislation in relation to Friendly Societies. No such rules have been made. Given that the intention would appear to be for special rules to apply (as opposed to the Insolvency Rules 1986, which apply to Companies Act Companies), there would appear to be no applicable rules currently, and therefore there is no equivalent for Friendly Societies of Rule 4.90 of the Insolvency Rules 1986, which is the insolvency set-off provision applicable to Companies Act Companies.

We noted in Annex 3 of the ISDA Netting Opinion that the same position applies in relation to English Building Societies. As in the case of English Building Societies, no official explanation for this state of affairs has ever been given. This unsatisfactory state of affairs in relation to both

English Building Societies and Friendly Societies was highlighted by the Financial Markets Law Committee in December 2007, but so far the government has taken no action to remedy this lacuna.[29]

It is possible that a Friendly Society could be made subject to a scheme of arrangement under Part 26 of the Companies Act 2006 for the reasons given in paragraph 3.4 of Annex 4 to the ISDA Netting Opinion in relation to Standard Chartered Bank, which is a Chartered Corporation. The same arguments as apply in relation to a Chartered Corporation would arguably also apply in relation to a Friendly Society.[30]

2.2 *Close-out netting against a Friendly Society*

In any event, we believe that the close-out netting provisions of the ISDA Master Agreement would be enforceable against a Friendly Society in the event of its winding up, without reliance on a statutory insolvency set-off rule, for the reasons we give in part III.3(3)(a) of the ISDA Netting Opinion in relation to an English Company on the basis that the close-out netting provisions of the ISDA Master Agreement do not involve contractual set-off (other than to the limited extent that it includes Unpaid Amounts due from the Defaulting Party, as discussed in the ISDA Netting Opinion) but simply represent an accounting of rights and liabilities under a single agreement following the designation or deemed occurrence of an Early Termination Date (sometimes referred to as the "flawed asset" approach to close-out netting).

If, however, the court were to construe the close-out netting provisions of the ISDA Master Agreement as operating by way of contractual set-off rather than pursuant to the single agreement (or "flawed asset") approach described above, we also consider that the close-out netting provisions of the ISDA Master Agreement would be enforceable against a Friendly Society. Our reasons for this view are principally those set out in part III.3(3)(a) of the ISDA Netting Opinion in relation to an English Company, supplemented by our view that an English court would find that insolvency set-off applies, despite the fact that there is no statutory insolvency set-off rule for Friendly Societies. We believe this would be the result because it is clear, in our view, that the lack of insolvency rules for Friendly Societies is a failure of administration rather than a deliberate policy choice, much less an expression of the will of Parliament.

The policy reasons in favour of insolvency set-off for Friendly Societies are as strong as they are in relation to individuals or companies, and there is a common law basis for the insolvency set-off provision which pre-dates its first appearance in statutory form in 1705. An English court would therefore, in our view, either find that insolvency set-off applies as a matter of common law in relation to a Friendly Society in winding up or, alternatively, would find that the close-out netting provisions of the ISDA Master Agreement viewed as a form of contractual set-off do not offend against any mandatory rule of English insolvency law and are therefore enforceable in accordance with their terms.

If a Friendly Society were to enter into a scheme of arrangement under Part 26 of the Companies Act 2006, the close-out netting provisions of the ISDA Master Agreement would be enforceable against the Friendly Society on the same basis as the close-out netting provisions would be enforceable against an English Company, as set out in part III.3(3)(d) of the ISDA Netting Opinion.

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29 The Financial Markets Law Committee published a paper in December 2007 entitled "Building Society and Friendly Society Set-off: Proposal for a Mandatory Insolvency Set-off Rule Applicable to Building Societies and Incorporated Friendly Societies", which deals with these issues in some detail. The paper may be found on the FMLC website at <http://www.fmlc.org/Pages/papers.aspx> accessed 13 May 2012.

30 The key to the argument is the breadth of the word "company" in section 895(2)(b) of the Companies Act 2006, as discussed in part 3.4 of Annex 4 to the ISDA Netting Opinion. It is clear that this is intended to be broader than a Companies Act Company. A Friendly Society is a body corporate and the fact that it is a mutual would not exclude it from the scope of the word "company" in that context.

ANNEX 3

I&P SOCIETY

In this Annex 3, we set out our views on the enforceability of the close-out netting provisions of the ISDA Master Agreement against an I&P Society in the event that insolvency proceedings are commenced in England in respect of the I&P Society. In this Annex 3 we consider only an I&P Society that is neither an English Insurance Company nor an English Charity nor otherwise subject to a special regulatory regime. In Annex 6 we consider an I&P Society that is an Insurance Company, and in Annex 8 we consider an I&P Society that is an English Charity.

Subject to the more detailed discussion below, the types of insolvency proceeding that may be commenced in England in respect of an I&P Society are, pursuant to section 55 of the Industrial and Provident Societies Act 1965, a voluntary or compulsory winding up under the Insolvency Act 1986. It is also possible that an I&P Society could be made subject to a scheme of arrangement under Part 26 of the Companies Act 2006.

1. Conclusion

On the basis of the assumptions and subject to the qualifications in part III of the ISDA Netting Opinion as modified and supplemented by this supplemental opinion, including this Annex 3, we are of the view that our conclusions in part III.3 of the ISDA Netting Opinion would apply to an I&P Society in the event that insolvency proceedings are commenced in England in respect of the I&P Society.

2. Analysis

2.1 *Insolvency proceedings in respect of an I&P Society*

Section 55 of the Industrial and Provident Societies Act 1965 states that an I&P Society "may be dissolved on its being wound up in pursuance of an order or resolution made as is directed in the case of companies registered under the Companies Acts… The provisions relating to the winding up of companies registered under the Companies Acts have effect in relation to a registered society as if the society were such a company…". Therefore the provisions of the Insolvency Act 1986 relating to the winding up of companies apply to I&P Societies, with some minor modifications that are not material to the questions considered in this supplemental opinion.

There are no equivalent provisions in the Industrial and Provident Societies Act 1965 that apply the companies administration regime to I&P Societies. However, section 255 of the Enterprise Act 2002 provides the Treasury with the power to provide by order for an administration regime for I&P Societies. To date, no such order has been made.

The Industrial and Provident Societies Act 1965 does not give detailed guidance as to how the companies winding-up regime will apply to an I&P Society, however Harman J in *Re Norse Self Build Association*[31] held that section 55 of that Act enables an I&P Society to be wound up in exactly the same way as if it were a Companies Act Company and that it is unnecessary to have resort to the power to wind up unregistered companies in Part V of the Insolvency Act 1986. This means that the Insolvency Rules 1986 as far as they are relevant to a winding up would apply to the winding up of an I&P Society, including the insolvency set-off provision in Rule 4.90.

[31] [1985] BCLC 219.

An I&P Society may not be made subject to a company voluntary arrangement or to administration proceedings under the Insolvency Act 1986. Each of these regimes is limited to Companies Act Companies and certain foreign companies.[32]

It is possible that an I&P Society could be made subject to a scheme of arrangement under Part 26 of the Companies Act 2006 for the reasons given in paragraph 3.4 of Annex 4 to the ISDA Netting Opinion in relation to Standard Chartered Bank, which is a Chartered Corporation. The same arguments as apply in relation to a Chartered Corporation would arguably also apply in relation to an I&P Society.[33]

2.2 *Close-out netting against an I&P Society*

We are of the view that the close-out netting provisions of the ISDA Master Agreement would be enforceable against an I&P Society in the event of its winding up for the reasons we give in part III.3(3)(a) of the ISDA Netting Opinion in relation to an English Company on the basis that the close-out netting provisions of the ISDA Master Agreement do not involve contractual set-off (other than to the limited extent that it includes Unpaid Amounts due from the Defaulting Party, as discussed in the ISDA Netting Opinion) but simply represent an accounting of rights and liabilities under a single agreement following the designation or deemed occurrence of an Early Termination Date (sometimes referred to as the "flawed asset" approach to close-out netting).

If, however, the court were to construe the close-out netting provisions of the ISDA Master Agreement as operating by way of contractual set-off rather than pursuant to the single agreement (or "flawed asset") approach described above, we also consider that the close-out netting provisions of the ISDA Master Agreement would be enforceable against an I&P Society for the reasons set out in part III.3(3)(a) of the ISDA Netting Opinion in relation to an English Company.

If an I&P Society were to enter into a scheme of arrangement under Part 26 of the Companies Act 2006, the close-out netting provisions of the ISDA Master Agreement would be enforceable against the I&P Society on the same basis as the close-out netting provisions would be enforceable against an English Company, as set out in part III.3(3)(d) of the ISDA Netting Opinion.

32 In relation to company voluntary arrangements, see the definition of "company" in section 1(4) of the Insolvency Act 1986, and in relation to administration proceedings, see the definition of "company" in paragraph 111(1A) of Schedule B1 to the Insolvency Act 1986. See also *Re Dairy Farmers of Britain Ltd* [2009] EWHC 1389 (Ch), which discusses the definition of "company" for these purposes in relation to I&P Societies.

33 The key to the argument is the breadth of the word "company" in section 895(2)(b) of the Companies Act 2006, as discussed in part 3.4 of Annex 4 to the ISDA Netting Opinion. It is clear that this is intended to be broader than a Companies Act Company. An I&P Society is a body corporate and the fact that it is a mutual would not exclude it from the scope of the word "company" in that context.

STATUTORY CORPORATION

In this Annex 4, we set out our views on the enforceability of the close-out netting provisions of the ISDA Master Agreement against a Statutory Corporation in the event that insolvency proceedings are commenced in England in respect of the Statutory Corporation. In this Annex 4 we consider only a Statutory Corporation that is neither an English Insurance Company nor an English Charity nor otherwise subject to a special regulatory regime. In Annex 6 we consider a Statutory Corporation that is an Insurance Company, and in Annex 8 we consider a Statutory Corporation that is an English Charity.

Subject to the more detailed discussion below, the types of insolvency proceeding that may be commenced in England in respect of a Statutory Corporation established by a private Act of Parliament are a voluntary or compulsory winding up under the Insolvency Act 1986. It is also possible that a Statutory Corporation could be made subject to a scheme of arrangement under Part 26 of the Companies Act 2006.

1. Conclusion

On the basis of the assumptions and subject to the qualifications in part III of the ISDA Netting Opinion as modified and supplemented by this supplemental opinion, including this Annex 4, we are of the view that our conclusions in part III.3 of the ISDA Netting Opinion would apply to a Statutory Corporation in the event that insolvency proceedings are commenced in England in respect of the Statutory Corporation.

2. Analysis

2.1 *Insolvency proceedings in respect of a Statutory Corporation*

There is good authority for the view that a Statutory Corporation established by a private Act of Parliament may be wound up as an "unregistered company" under section 221 of the Insolvency Act 1986.[34]

Section 221(1) provides that "all of the provisions of this Act about winding up apply to an unregistered company with the exceptions and additions mentioned in the following subsections". Section 221(4) provides that "[n]o unregistered company shall be wound up under this Act voluntarily, except in accordance with the EC Regulation". "EC Regulation" means the EC Insolvency Regulation.[35] Under the EC Insolvency Regulation a company incorporated in an EU member state with its centre of main interests (**COMI**) in England may be wound up in England under a creditors' voluntary winding up.[36] We have defined a Statutory Corporation to be "a body corporate established by private Act of Parliament with its principal place of business in England". A Statutory Corporation will therefore virtually always have its COMI in England for purposes of the EC Insolvency Regulation. As England is part of the United Kingdom, which is an EU member state, a Statutory Corporation may be wound up voluntarily in England. If not wound up voluntarily, a Statutory Corporation will be wound up by the court (compulsory winding up).

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34 See Derek French, *Applications to Wind Up Companies* (2nd edn, OUP 2008), 91, where numerous cases are cited to support this proposition. Although these cases were decided in relation to the winding up provisions of earlier companies legislation, the same principles appear to us to be applicable in relation to Part V of the Insolvency Act 1986, given the similarity of concepts and terminology in the earlier legislation and the clear intent that these provisions are a consolidation (although amended in certain respects), and therefore a continuation, of the earlier regimes. In support of this approach to these earlier cases, see *Re a Debtor (No 784 of 1991* [1992] Ch 554, 558-559 (per Hoffmann J); and *Re Modern Jet Support Centre Ltd* [2005] EWHC 1611 (Ch), [2005] 1 WLR 3880 [22], [30]-[31]. See also Len Sealy and David Milman, *Annotated Guide to the Insolvency Legislation*, vol 1 (14th edn, Sweet & Maxwell 2011) 221.

35 Council Regulation 1346/2000/EC on insolvency proceedings [2000] OJ L160.

36 *Re TXU Europe German Finance BV* [2005] BCC 90.

Whether the winding up of a Statutory Corporation is conducted on a voluntary or compulsory basis, the provisions of the Insolvency Rules 1986 relevant to a winding up will apply to the winding up of the Statutory Corporation, including the insolvency set-off provision in Rule 4.90.[37]

A Statutory Corporation may not be made subject to a company voluntary arrangement or to administration proceedings under the Insolvency Act 1986. Each of these regimes is limited to Companies Act Companies and certain foreign companies.[38]

It is possible that a Statutory Corporation could be made subject to a scheme of arrangement under Part 26 of the Companies Act 2006 for the reasons given in paragraph 3.4 of Annex 4 to the ISDA Netting Opinion in relation to Standard Chartered Bank, which is a Chartered Corporation. The same arguments as apply in relation to a Chartered Corporation would also apply in relation to a Statutory Corporation.

In relation to any Statutory Corporation, it is possible that the private Act of Parliament under which it is established could provide for its being subject to winding up or some other form of insolvency proceeding, and therefore we advise a party proposing to deal with a Statutory Corporation to check the relevant statute in this regard. For the purposes of this Annex 4, we assume that the relevant statute contains no such provisions or, if it does, we assume that such provisions do not affect our conclusions in this Annex 4.

2.2 *Close-out netting against a Statutory Corporation*

If a Statutory Corporation established by a private Act of Parliament were wound up as an "unregistered company" under section 221 of the Insolvency Act 1986, then, in our view, the close-out netting provisions of the ISDA Master Agreement would be enforceable against that Statutory Corporation for the reasons we give in part III.3(3)(a) of the ISDA Netting Opinion in relation to an English Company on the basis that the close-out netting provisions of the ISDA Master Agreement do not involve contractual set-off (other than to the limited extent that it includes Unpaid Amounts due from the Defaulting Party, as discussed in the ISDA Netting Opinion) but simply represent an accounting of rights and liabilities under a single agreement following the designation or deemed occurrence of an Early Termination Date (sometimes referred to as the "flawed asset" approach to close-out netting).

If, however, the court were to construe the close-out netting provisions of the ISDA Master Agreement as operating by way of contractual set-off rather than pursuant to the single agreement (or "flawed asset") approach described above, we also consider that the close-out netting provisions of the ISDA Master Agreement would be enforceable against the Statutory Corporation for the reasons set out in part III.3(3)(a) of the ISDA Netting Opinion in relation to an English Company.

If a Statutory Corporation were to enter into a scheme of arrangement under Part 26 of the Companies Act 2006, the close-out netting provisions of the ISDA Master Agreement would be enforceable against the Statutory Corporation on the same basis as the close-out netting provisions would be enforceable against an English Company, as set out in part III.3(3)(d) of the ISDA Netting Opinion.

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37 Where a statutory corporation has been established by an Act of Parliament for a public purpose without private shareholders, *obiter dicta* of Denning LJ in the Court of Appeal decision in *Tamlin v Hannaford* [1950] 1 KB 18 provides persuasive support for the view that such a statutory corporation is not liable to be wound up at the suit of any creditor. An earlier case, *Re Exmouth Docks Co.* (1873) LR 17 Eq 181, suggested that a court would be unlikely to make a winding up order in relation to a statutory corporation established for a public purpose under existing legislation. The court was of the view that instead a further Act of Parliament would need to be passed specifically to provide for the winding up. The relationship between the decision in *Exmouth Docks* and the dicta in *Tamlin* is not entirely clear, but together they appear to exclude the possibility of a court's being able to wind up a statutory corporation established for a public purpose without a further Act of Parliament. As a general rule, however, a statutory corporation established for a public purpose is normally established by a public general, rather than private, Act of Parliament and is therefore excluded from the scope of this supplemental opinion. See note 4.

38 In relation to company voluntary arrangements, see the definition of "company" in section 1(4) of the Insolvency Act 1986, and in relation to administration proceedings, see the definition of "company" in paragraph 111(1A) of Schedule B1 to the Insolvency Act 1986.

ANNEX 5

CHARTERED CORPORATION

In this Annex 5, we set out our views on the enforceability of the close-out netting provisions of the ISDA Master Agreement against a Chartered Corporation in the event that insolvency proceedings are commenced in England in respect of the Chartered Corporation. In this Annex 5 we consider only a Chartered Corporation that is neither an English Insurance Company nor an English Charity nor otherwise subject to a special regulatory regime. In Annex 6 we consider a Chartered Corporation that is an Insurance Company, and in Annex 8 we consider a Chartered Corporation that is an English Charity.

Subject to the more detailed discussion below, the types of insolvency proceeding that may be commenced in England in respect of a Chartered Corporation are a voluntary or compulsory winding up under the Insolvency Act 1986. It is also possible that a Chartered Corporation could be made subject to a scheme of arrangement under Part 26 of the Companies Act 2006.

1. Conclusion

On the basis of the assumptions and subject to the qualifications in part III of the ISDA Netting Opinion as modified and supplemented by this supplemental opinion, including this Annex 5, we are of the view that our conclusions in part III.3 of the ISDA Netting Opinion would apply to a Chartered Corporation in the event that insolvency proceedings are commenced in England in respect of the Chartered Corporation.

2. Analysis

2.1 *Insolvency proceedings in respect of a Chartered Corporation*

There is good authority for the view that a Chartered Corporation may be wound up as an "unregistered company" under section 221 of the Insolvency Act 1986.[39]

Section 221(1) provides that "all of the provisions of this Act about winding up apply to an unregistered company with the exceptions and additions mentioned in the following subsections". For the reasons given in relation to a Statutory Corporation in 2.1 of Annex 4 and on the basis of our definition of a Chartered Corporation ("a body corporate established by royal charter granted by the Crown with its principal place of business in England"), in our view a Chartered Corporation may be subject to voluntary or compulsory winding up under the Insolvency Act 1986.

Whether the winding up of a Chartered Corporation is conducted on a voluntary or compulsory basis, the provisions of the Insolvency Rules 1986 relevant to a winding up will apply to the winding up of the Chartered Corporation, including the insolvency set-off provision in Rule 4.90.

[39] *Re Oriental Bank Corporation* (1885) 54 LJ Ch 481 (CA); *Re Commercial Buildings Co of Dublin* [1938] IR 477. The latter is an Irish case, but it was decided in relation to a corporation established by a royal charter granted on 1 January 1798 with regard to the winding up provisions of the Companies (Consolidation) Act 1908, which at that time applied both in England and Ireland. Although the Irish judge was somewhat sceptical about the basis of the earlier decision in *Re Oriental Bank Corporation*, which was decided by reference to the winding up provisions of the Joint Stock Companies Winding-up Act 1848, he was unequivocal that a chartered corporation could be wound up under the winding up provisions of the 1908 Act. In *Re English, Scottish and Australian Chartered Bank* [1893] 3 Ch 385 (CA) 405, the Court of Appeal considered various issues arising out of a proposed scheme of arrangement in connection with the winding up of the English, Scottish and Australian Chartered Bank, a chartered corporation, the principal business of which was in Australia. It was taken for granted by the Court of Appeal, and not an issue in dispute between the parties, that the High Court had the power to order the winding up of the bank. Derek French (*op cit* note 34 at p 41) refers to other cases that are similarly concerned with later proceedings in relation to a chartered company that was already in winding up.

A Chartered Corporation may not be made subject to a company voluntary arrangement or to administration proceedings under the Insolvency Act 1986. Each of these regimes is limited to Companies Act Companies and certain foreign companies.[40]

It is possible that a Chartered Corporation could be made subject to a scheme of arrangement under Part 26 of the Companies Act 2006 for the reasons given in paragraph 3.4 of Annex 4 to the ISDA Netting Opinion in relation to Standard Chartered Bank, which is a Chartered Corporation.

In relation to any Chartered Corporation, it is possible that the royal charter under which it is established could provide for its winding up in certain circumstances or may otherwise provide for the revocation of the charter or the dissolution of the Chartered Corporation. We therefore advise a party proposing to deal with a Chartered Corporation to check the royal charter (and any related constitutional documents such as any bye-laws or rules made under the royal charter) in this regard. For the purposes of this Annex 5, we assume that the relevant royal charter (or any related constitutional document) contains no such provisions or, if it does, we assume that such provisions do not affect our conclusions in this Annex 5.

2.2 *Close-out netting against a Chartered Corporation*

If a Chartered Corporation were wound up as an "unregistered company" under section 221 of the Insolvency Act 1986, then, in our view, the close-out netting provisions of the ISDA Master Agreement would be enforceable against that Chartered Corporation for the reasons we give in part III.3(3)(a) of the ISDA Netting Opinion in relation to an English Company on the basis that the close-out netting provisions of the ISDA Master Agreement do not involve contractual set-off (other than to the limited extent that it includes Unpaid Amounts due from the Defaulting Party, as discussed in the ISDA Netting Opinion) but simply represent an accounting of rights and liabilities under a single agreement following the designation or deemed occurrence of an Early Termination Date (sometimes referred to as the "flawed asset" approach to close-out netting).

If, however, the court were to construe the close-out netting provisions of the ISDA Master Agreement as operating by way of contractual set-off rather than pursuant to the single agreement (or "flawed asset") approach described above, we also consider that the close-out netting provisions of the ISDA Master Agreement would be enforceable against the Chartered Corporation for the reasons set out in part III.3(3)(a) of the ISDA Netting Opinion in relation to an English Company.

If a Chartered Corporation were to enter into a scheme of arrangement under Part 26 of the Companies Act 2006, the close-out netting provisions of the ISDA Master Agreement would be enforceable against the Chartered Corporation on the same basis as the close-out netting provisions would be enforceable against an English Company, as set out in part III.3(3)(d) of the ISDA Netting Opinion.

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40 In relation to company voluntary arrangements, see the definition of "company" in section 1(4) of the Insolvency Act 1986, and in relation to administration proceedings, see the definition of "company" in paragraph 111(1A) of Schedule B1 to the Insolvency Act 1986.

ANNEX 6

ENGLISH INSURANCE COMPANY

In this Annex 6, we set out our views on the enforceability of the close-out netting provisions of the ISDA Master Agreement against an English Insurance Company in the event that insolvency proceedings are commenced in England in respect of the English Insurance Company.

The types of insolvency proceeding that may be commenced in England in respect of an English Insurance Company depend on the legal form in which it is established as well as specific insolvency rules applicable to an English Insurance Company as discussed below in this Annex 6.

A summary of the types of insolvencing proceeding that may be commenced in England is set out, in respect of:

(a) a Companies Act Company, in part III.1(4) of the ISDA Netting Opinion;

(b) a Friendly Society, in Annex 2;

(c) an I&P Society, in Annex 3;

(d) a Statutory Corporation, in Annex 4; and

(e) a Chartered Corporation, in Annex 5.

One of the most important changes made by the specific insolvency rules applicable to insurers is that an English Insurance Company that is an I&P Society, Statutory Corporation or Chartered Corporation can be put into administration proceedings. Normally administration proceedings are not available in relation these legal forms of entity, as noted in Annexes 3, 4 and 5, respectively. Administration proceedings remain unavailable for an English Insurance Company that is a Friendly Society.

1. Conclusion

On the basis of the assumptions and subject to the qualifications in part III of the ISDA Netting Opinion as modified and supplemented by this supplemental opinion, including this Annex 6, we are of the view that our conclusions in part III.3 of the ISDA Netting Opinion would apply to an English Insurance Company in the event that insolvency proceedings are commenced in England in respect of the English Insurance Company.

2. Analysis

2.1 *English Insurance Companies*

As noted in part 1 of this supplemental opinion, an English Insurance Company may be organised in one of a number of different legal forms. The most common forms are the five forms covered by this supplemental opinion. As a general rule the following analysis in this Annex 6 applies to an English Insurance Company regardless of the form in which it is established, but there are some points regarding which the analysis is affected by the relevant form of organisation. These points are noted below.

There are a number of provisions of English law that apply differently to English Insurance Companies than they do to other companies established in the United Kingdom. There are also some differences between the provisions applicable to mutual and proprietary English Insurance

Companies, and between English Insurance Companies carrying on direct insurance business and reinsurance business, but these are less significant. We highlight relevant differences below.

So far as this advice is concerned, the legal provisions that are likely to be relevant are:

(1) the specific insolvency rules applicable to English Insurance Companies, which modify the insolvency regimes that would normally apply; and

(2) the rules governing the financial regulation of English Insurance Companies (which in turn account for certain particular features of the insolvency rules, as described below).

The legal framework for insurance regulation in the United Kingdom is currently set out in the Financial Services and Markets Act 2000 together with rules and regulations made by the Treasury and the Financial Services Authority under powers conferred by the Financial Services and Markets Act 2000. This regime broadly implements the requirements of the EU life and non-life Insurance Directives.[41] The Financial Services Authority publishes a Handbook of rules and guidance made pursuant to powers conferred on it under the Financial Services and Markets Act 2000. Of particular relevance is the section of the Handbook entitled "Prudential Sourcebook for Insurers" (**INSPRU**).[42]

The effecting and carrying out of contracts of insurance as principal in the United Kingdom are (subject to minor exclusions) regulated activities for the purposes of the Financial Services and Markets Act 2000,[43] and persons who carry on such activities require authorisation under the Financial Services and Markets Act 2000 and the appropriate permission under Part IV of the Financial Services and Markets Act 2000 having regard to the regulated activities performed. Authorisation and supervisory powers are conferred by the Financial Services and Markets Act 2000 on the Financial Services Authority, including the power to grant and vary Part IV permissions. The Financial Services and Markets Act 2000 and rules and regulations made under it together impose a number of requirements on an English Insurance Company that are in addition to the requirements contained in its constitutional documents and the requirements of the Companies Act 2006.

For the purposes of the Financial Services and Markets Act 2000, it is necessary to make a distinction between English Insurance Companies conducting "long-term insurance business" (**Life Insurance Companies**) and those conducting "general insurance business" (**General Insurance Companies**). Long-term insurance business would include, for example, life assurance, annuity and pension fund management whereas general insurance business would include what is sometimes known as "non-life" or "property and casualty" business (including, for example, household, vehicle, liability, accident and sickness insurance). There are important differences between the regulatory rules governing long-term insurance business (which includes many savings products) and general insurance business, the former affording, overall, a higher level of policyholder protection.

"Long-term" and "general" insurance business are defined in more detail in the Handbook. The Financial Services Authority maintains a register of all companies (including, *inter alia*, English Insurance Companies) that are authorised under the Financial Services and Markets Act 2000. This register states what class or classes of business (long-term or general and the sub-divisions thereof) each English Insurance Company may carry on.

41 Consolidated Life Directive 2002/83/EC; First, Second and Third Council Non-Life Directives (73/239/EEC, 88/357/EEC and 92/49/EEC), as amended by 2002/13/EC. The Reinsurance Directive 2005/68/EC, a modified version of the life and non-life Insurance Directives, applies to pure reinsurers (that is, insurers which only carry on reinsurance business).

42 The UK government is in the process of implementing its reform of the framework for financial regulation in the United Kingdom and the Financial Services Bill relating to these reforms was introduced in Parliament on 26 January 2012. The Financial Services Bill provides for the dual supervision of English Insurance Companies by two new regulators in substitution for the Financial Services Authority, the Prudential Regulatory Authority (which will be responsible for prudential supervision) and the Financial Conduct Authority (which will be responsible for conduct of business supervision). This change is not expected to affect materially the matters addressed in this supplemental opinion.

43 Financial Services & Markets Act 2000 (Regulated Activities) Order 2001 SI 2001/544, art 10. In the FSA Handbook, the business of effecting or carrying out contracts of insurance as principal is known as "insurance business".

Some English Insurance Companies (**Composites**) have permission to carry on both long-term and general insurance business. However, pursuant to the EU Consolidated Life Directive, an English Insurance Company will now, with certain exceptions, not be given permission to do so.[44] The main exceptions are for a few older English Insurance Companies established before 15 March 1979 and for pure reinsurers (to which the Directive does not apply).

Composites must maintain separate funds for their long-term and general insurance businesses and may not use assets of the long-term business to fund the general business. Therefore, when dealing with a Composite, it is particularly important for a party to know whether it is dealing with it in relation to its long-term business or its general business. If it is dealing with the Composite in relation to each business, it should have a separate ISDA Master Agreement for each and take particular care to ensure that each Transaction with that English Insurance Company is allocated to the correct ISDA Master Agreement for the business to which that Transaction relates. The party should therefore obtain from the Composite in relation to each Transaction, to be included in the relevant Confirmation, a specific representation as to the business to which the Transaction relates.

We assume for the purposes of the analysis in this Annex 6 that all Transactions between a party and an English Insurance Company under the ISDA Master Agreement are entered into for the purposes of either (a) the long-term insurance business of the English Insurance Company (in the case of an English Insurance Company that carries on long-term business) or (b) its other businesses (if any), and not a mixture of both.

2.2 *Modifications of general insolvency law in relation to an English Insurance Company*

Subject to certain modifications mentioned below, the winding up in England of an English Insurance Company is governed by the rules that would apply according to its legal form. Although there are various differences of detail in the winding up regimes that would apply to each form of English Insurance Company, each form is broadly subject to the winding up regime applicable to a Companies Act Company.

For all forms of English Insurance Company apart from a Friendly Society, this includes the application of the Insolvency Rules 1986 relevant to winding up, including the insolvency set-off provision in Rule 4.90. Although the Insolvency Rules 1986 would not apply in the winding up of an English Insurance Company that is a Friendly Society, we believe that a court would, to give proper effect to the winding up regime applicable to Friendly Societies, find that insolvency set-off applies, as discussed in more detail in Annex 2.

Accordingly, in contrasting the winding up regime that would normally apply to each of the five legal forms of English Insurance Company within the scope of this supplemental opinion with the winding up regime applicable to an English Insurance Company, we primarily refer below to the regime applicable to a Companies Act Company. None of the differences of detail in relation to the other four winding up regimes affects our conclusions in this Annex 6.

The insolvency regime applicable to each form of English Insurance Company, other than an English Insurance Company that only carries on reinsurance business (a **pure reinsurer**), is subject to certain provisions of the Insurers (Reorganisation and Winding Up) Regulations 2004 (the **RWU Regulations**).[45]

44 See INSPRU 1.5.17.
45 SI 2004/353.

In addition, the insolvency regime applicable to an English Insurance Company other than one established as a Friendly Society[46] is subject to:

(i) Part XXIV (sections 355 – 379) of the Financial Services and Markets Act 2000;

(ii) the Insurers (Winding Up) Rules 2001 (the **Winding Up Rules**),[47] made under section 379 of the Financial Services and Markets Act 2000; and

(iii) the Financial Services and Markets Act 2000 (Administration Orders Relating to Insurers) Order 2010 (the **Insurer Administration Order**),[48] made under section 360 of the Financial Services and Markets Act 2000.

The main modifications made by these instruments to the general rules are discussed below.

(a) Administration

Section 360 of the Financial Services and Markets Act 2000 empowers the Treasury by statutory order to apply the administration provisions of the Insolvency Act 1986 to English Insurance Companies, other than an English Insurance Company established as a Friendly Society,[49] subject to any specified modifications.

On 1 February 2011 the Insurer Administration Order, which consolidated the provisions of various statutory instruments relating to the application of Part II of the Insolvency Act 1986, came into effect.

Pursuant to the Insurer Administration Order, an English Insurance Company, other than a Friendly Society, is subject to the administration provisions in Schedule B1 to the Insolvency Act 1986, but such an administration must be commenced by order of the court. Appointment of an administrator out of court (that is, by filing prescribed documents with the court) is not possible in relation to an English Insurance Company. The basic time limit for the duration of an administration is extended from 12 to 30 months.

Pursuant to the Insurer Administration Order, as from 1 February 2011, rules equivalent to those already in place in respect of the winding up of Life Insurance Companies and Composites under section 376 of the Financial Services and Markets Act 2000 became applicable to the administration of Life Insurance Companies and Composites. A statutory duty is imposed upon the administrator to carry on the long-term insurance business (unless the court otherwise orders) with a view to it being transferred to another company as a going concern.

46 Part XXIV of the Financial Services and Markets Act 2000 includes various provisions relating to insolvency of authorised persons. In relation to English Insurance Companies, its provisions are limited to an "insurer". Under s 355 of the Financial Services and Markets Act 2000 the term "insurer" has such meaning as may be specified in an order made by the Treasury. The Treasury made such an order in the form of the Financial Services and Markets Act 2000 (Insolvency) (Definition of "Insurer") Order 2001 SI 2001/2634. Article 2 of that Order provides as follows: "In Part XXIV of the Act (insolvency), 'insurer' means any person who is carrying on a regulated activity of the kind specified by article 10(1) or (2) of the Regulated Activities Order (effecting and carrying out contracts of insurance) but who is not – (a) exempt from the general prohibition in respect of that regulated activity; (b) a friendly society; or (c) a person who effects or carries out contracts of insurance all of which fall within paragraphs 14 to 18 of Part I of Schedule 1 to the Regulated Activities Order in the course of, or for the purposes of, a banking business." An English Insurance Company established as a Friendly Society would therefore not fall within this definition. The four other legal forms of English Insurance Company covered by this supplemental opinion would fall within this definition.

47 SI 2001/3635.

48 SI 2010/3023.

49 See note 46.

(b) Priority of claims

There are important differences in the priority of claims against an English Insurance Company in liquidation compared to a Companies Act Company in liquidation. Under the general insolvency rules that apply in a liquidation, unsecured senior (that is, unsubordinated) creditors of a Companies Act Company rank equally with each other but behind other creditors in the following (descending) order of priority:

(i) in relation to realisations of assets subject to a floating charge:

(A) preferential creditors (discussed further below);

(B) unsecured creditors to the extent of the "prescribed part" (discussed further below);

(C) the expenses of the winding up (including the liquidator's remuneration); [50]

(D) the floating charge holder (to the extent of the charge); and

(ii) in relation to realisations of unsecured assets:

(A) the expenses of the winding up (including the liquidator's remuneration);

(B) preferential creditors;

(C) unsecured creditors to the extent of the "prescribed part".

The holder of a fixed charge over specific assets of a Companies Act Company will be paid in priority to all of the above claims to the extent of the holder's security over those assets under the fixed charge.

In an administration of a Companies Act Company, a different regime of priorities applies. Unsecured senior creditors of a company rank equally with each other but behind the following (in descending order of priority):

(i) creditors holding a fixed security (to the extent of their security);

(ii) the expenses of the administration (including the administrator's remuneration);

(iii) preferential creditors;

(iv) unsecured creditors to the extent of the "prescribed part"; and

(v) creditors holding a floating charge (to the extent of the charge).

In each case, preferential debts rank equally with each other. They include:

(i) occupational pension scheme contributions and state scheme premiums; and

[50] Section 176ZA of the Insolvency Act 1986 (introduced by section 1282 of the Companies Act 2006) and Rule 4.218 of the Insolvency Rules 1986 (introduced by The Insolvency (Amendment) Rules 2008 SI 2008/737) provide that the expenses of a winding up in England and Wales are payable out of the assets of the company available for payment to general creditors and, subject to Rules 4.218A to 4.218E of the Insolvency Rules 1986, out of the property comprised in or subject to a floating charge created by the company. Rules 4.218A to Rule 4.218E set out a reasonably detailed set of rules intended to protect the holder of a floating charge from erosion of its security by requiring that a liquidator obtain (a) the holder’s approval or authorisation of the amount of any liquidation expenses to be incurred by the liquidator in relation to legal proceedings for the purpose of preserving, realising or getting in any of the assets of the company or (b) in certain circumstances, for example, where the holder is the proposed defendant in the legal proceedings, the consent of the court.

(ii) remuneration of employees, for up to 4 months' wages and holiday entitlement, but with a £800 limit per employee.

The preferential status previously afforded to debts owed to the Crown by an insolvent company was abolished as a consequence of the introduction of the Enterprise Act 2002 on 15 September 2003. Accordingly, money owed to HM Revenue & Customs for income tax deducted at source, value-added tax, betting and gaming duties and social security contributions now rank as ordinary unsecured claims.

The Enterprise Act 2002 also created a new priority for unsecured creditors. Section 176A of the Insolvency Act provides that any receiver (including an administrative receiver), liquidator or administrator of a company is required to make a "prescribed part" of the floating charge realisations available for the satisfaction of unsecured debts in priority to the claims of the floating charge holder. This obligation does not apply if the floating charge realisations are less than a prescribed minimum and the relevant officeholder is of the view that the cost of making a distribution to unsecured creditors would be disproportionate to the benefits. The relevant officeholder may also apply to court for an order that the provisions of section 176A should not apply on the basis that the cost of making a distribution would be disproportionate to the benefits. The "prescribed part" is defined in the Insolvency Act 1986 (Prescribed Part) Order 2003 to be an amount equal to 50 per cent. of the first £10,000 of floating charge realisations plus 20 per cent. of the floating charge realisations thereafter, provided that such amount may not exceed £600,000. Section 176A applies to any floating charge granted on or after 15 September 2003.

In the case of an insolvent English Insurance Company (whether carrying on life or non-life or direct or reinsurance business and whether mutual or proprietary), the application of the above rules would mean that, generally speaking, the claims of its policyholders would rank equally with those of general unsecured and unsubordinated creditors in the case of a winding up or, where applicable, an administration of the English Insurance Company.

However, the position is considerably altered as regards direct insurance undertakings (that is, not pure reinsurers) by the RWU Regulations, which give effect in the United Kingdom to the Reorganisation and Winding-up of Insurance Undertakings Directive 2001/17/EC (the **Winding Up Directive**).

The Winding Up Directive applies to direct insurance undertakings (not pure reinsurers) which have their head office or (if the undertaking's head office is situated in a third country) a branch within the European Economic Area (**EEA**). It confers exclusive jurisdiction over the reorganisation and winding up of direct insurance undertakings on the courts or other competent authorities of the EEA member state in which the head office or branch is situated, and provides for the decisions of those authorities to be recognised throughout the EEA.

Although for the most part the domestic rules applicable in the EEA member state of the head office or branch of the insurance undertaking will apply to a reorganisation or winding up, this is subject to some qualifications. In particular, EEA member states are required to introduce one of two systems of priority:

(i) direct insurance claims (that is, not reinsurance claims) must, with respect to assets representing the technical provisions (that is, assets set aside to cover liabilities to policyholders), take absolute precedence over any other claim on the undertaking; or

(ii) direct insurance claims must, with respect to the whole of the undertaking's assets, take precedence over any other claim on the insurance undertaking with the only possible exception of:

(A) claims by employees arising from employment contracts and employment relationships;

(B) claims by public bodies on taxes;

(C) claims by social security systems; and

(D) claims on assets subject to "rights in rem".

Whichever system is chosen, precedence may also be given to the whole or part of the winding-up expenses.

The RWU Regulations adopt option (ii) above, so that:

(1) preferential debts, as described above and as amended by the Enterprise Act 2002, have priority over direct insurance claims; and

(2) secured debts and proprietary rights are not affected by the winding up provided that they are treated as "rights in rem" for the purposes of the Winding Up Directive. The term "rights in rem" is not defined in the Winding Up Directive or in the RWU Regulations, but we consider that it will cover most, if not all, proprietary rights currently recognised by English law.

The priority afforded to direct insurance claims is also preserved in respect of the "prescribed part" of the floating charge realisations that a receiver (including an administrative receiver), liquidator or administrator of a company is required to make available for the satisfaction of unsecured debts in priority to the claims of the floating charge holder.[51] The RWU Regulations provide that such direct insurance debts must be paid out of the prescribed part in priority to all other unsecured claims.

Accordingly, in the case of a winding-up[52] of an English Insurance Company, unsecured senior creditors of the English Insurance Company rank equally with each other but behind other creditors in the following (descending) order of priority:

(i) in relation to realisations of assets subject to a floating charge:

(A) preferential creditors (as defined above);

(B) unsecured creditors to the extent of the prescribed part, with creditors with direct insurance claims taking priority over other unsecured creditors in respect of the prescribed part;

(C) the expenses of the winding up (including the liquidator's remuneration);

(D) the floating charge holder (to the extent of the charge);

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[51] The prescribed part is to be reserved pursuant to section 176A of the Insolvency Act 1986. Please refer to the discussion above on section 176A where the circumstances in which the prescribed part must be reserved are described.

[52] Presently if an administrator of an English Insurance Company makes a distribution to creditors under paragraph 65 of Schedule B1 to the Insolvency Act 1986, the RWU Regulations do not specifically provide that he or she should give priority to direct insurance claims. The special priority to direct insurance claims only applies in the case of the winding-up of an Insurance Company or if an administrator of an English Insurance Company makes a distribution under the powers conferred by Schedule 1 to the Insolvency Act (see the Schedule to the Insurer Administration Order). However, paragraph 65 of Schedule B1 to the Insolvency Act 1986 provides that section 175 of the Insolvency Act 1986 (which governs preferential debts) applies in an administration as it applies in a winding-up. As section 175 of the Insolvency Act 1986 is disapplied by the RWU Regulations in a winding-up, and is replaced with the priority provisions in the RWU Regulations, it is arguable that the priority rules in the RWU Regulations will apply in an administration. Amendment legislation may be required to clarify the position.

(E) creditors with direct insurance claims (to the extent not fully satisfied under (B) above); and

(ii) in relation to realisations of unsecured assets:

(A) the expenses of the winding up (including the liquidator's remuneration);

(B) preferential creditors;

(C) creditors with direct insurance claims.

As in the case of a holder of a fixed charge granted by an English Company, the holder of a fixed charge granted by an English Insurance Company will be paid in priority to all of the above claims to the extent of the holder's security over those assets under the fixed charge.

The RWU Regulations provide expressly that insolvency proceedings in respect of an English Insurance Company will be governed by general English insolvency law, subject to modification by the RWU Regulations.[53] The RWU Regulations do not modify the insolvency set-off provisions applicable in a winding up and, where applicable, an administration, which therefore apply in the winding up or, as the case may be, administration of an English Insurance Company.

Liquidation expenses, preferential claims and direct insurance claims will rank ahead of the claims of general unsecured creditors (where those unsecured claims are not preferential) after the exercise of any rights of set-off. An unsecured net amount owed by an English Insurance Company under an ISDA Master Agreement will not be a preferential debt under the RWU Regulations. Therefore a counterparty to an ISDA Master Agreement with an English Insurance Company will rank behind preferential debts and, more importantly, behind direct insurance claims.

(c) Composites

The special priority afforded to direct insurance claims detailed in (b) above[54] also applies to Composites which are direct insurance undertakings. In addition, the RWU Regulations make provision, in the case of such an undertaking which is a "non-transferring" Composite (that is, a Composite the long-term business of which has not been, and is not to be, transferred as a going concern to a person who may lawfully carry out those contracts, in accordance with section 376(2) of the Financial Services and Markets Act 2000), for the separate application of long-term and general business assets in a winding-up to the payment of preferential debts and direct insurance liabilities, as discussed further below.

The result is that in the case of any winding up of a non-transferring Composite on or after 20 April 2003 (or at least one which carries on direct insurance business, as the position as regards a Composite which is a pure reinsurer is unclear), the long-term and general business assets must be applied in discharge, respectively, of the long-term and general business preferential and insurance liabilities, any excess of the long-term assets being applied to meet a deficit in the general business preferential and insurance liabilities and vice versa.[55]

[53] RWU Regulations, reg 8.

[54] Both the priority over unsecured creditors generally, and the priority over unsecured creditors in respect of any prescribed part preserved pursuant to section 176A of the Insolvency Act 1986.

[55] An amendment to the RWU Regulations made by reg 2(4) of the Insurers (Reorganisation and Winding Up) (Amendment) Regulations 2004 SI 2004/546 clarified that the preferential debts should be paid after the expenses of the winding up. However, the amendment was not made to the equivalent provision applying to non-transferring Composites. We consider this is likely to be an oversight in the drafting rather than a substantive change to the law.

It should also be noted that INSPRU 1.5.30 requires an English Insurance Company to apply assets held in respect of its long-term business only for the purposes of that long-term business.

The definition of preferential debts has also been extended to include any winding-up expenses apportioned to either the long-term assets or general business assets so that these expenses will be discharged out of the respective funds. It is not entirely clear whether a liquidator is obliged to discharge unsecured creditors not falling within the category of preferential or insurance liabilities from the separate funds of long-term business assets and general business assets.[56]

Accordingly, it is our view that, on the winding up of a non-transferring Composite, it may not be possible to net Transactions entered into in connection with the English Insurance Company's long-term business against Transactions entered into in connection with its general business and such mingling of Transactions should be avoided.

(d) Winding-up restrictions (Life Insurance Companies)

Each form of English Insurance Company may be wound up voluntarily under the Insolvency Act 1986. However, in the case of a Life Insurance Company or Composite, section 366(1) of the Financial Services and Markets Act 2000 requires that the Financial Services Authority's consent is obtained before such voluntary liquidation is commenced.

Also, on the insolvency of a Life Insurance Company or Composite, a statutory duty under section 376(2) of the Financial Services and Markets Act 2000 is imposed upon the liquidator to carry on its long-term insurance business (unless the court otherwise orders) with a view to it being transferred to another company as a going concern. In practice, as discussed further below, this will usually result in a transfer of business under Part VII of the Financial Services and Markets Act 2000 or some form of arrangement being made between the liquidator and the unsecured creditors in respect of the long-term business of the insolvent English Insurance Company.

The provisions in sections 366(1) and 376(2) are intended to protect the legitimate interests of policyholders rather than non-insurance creditors, however we do not believe that either of the provisions in section 366(1) and 376(2) would prevent, or confer a power on the Financial Services Authority to prevent, the exercise by a Non-defaulting Party of its rights under the close-out netting provisions of the ISDA Master Agreement.

(e) Schemes of arrangement

Each form of English Insurance Company may, at least in theory, be made subject to a scheme of arrangement under Part 26 of the Companies Act 2006. In recent years the insolvency of General Insurance Companies with substantial long tail liabilities (that is, liabilities such as those arising from asbestosis which emerge over a long period) were typically been resolved through a scheme of arrangement under section 425 of the Companies Act 1985 under which liabilities were commuted, or part paid as the assets (including reinsurance recoveries) accrue, rather than by a winding up. A smaller number of schemes have also been drawn up for Life Insurance Companies.

[56] There are some provisions in the RWU Regulations which suggests this may have been the intention. For example, refer to regulations 28(3) and 28(4) of the RWU Regulations relating to proofs of debt lodged by creditors.

Section 425 and related provisions of the Companies Act 1985 were replaced, subject to certain savings and transitional provisions, by Part 26 of the Companies Act 2006 with effect from 6 April 2008. The Companies Act 2006 scheme of arrangement provisions are, for present purposes, broadly the same as those in the Companies Act 1985.[57]

The RWU Regulations do not directly apply to such schemes. However, in *Marconi Corporation plc v Marconi plc,*[58] Lindsay J observed that "where the scheme is in practical terms an alternative to a liquidation or administration, it is not wrong… to bear in mind, in the composition of classes of creditors, how the respective creditors would have been treated in the alternative insolvency". The priority rules laid down in the RWU Regulations for liquidations may therefore have an indirect impact on distributions though schemes. Prior to the RWU Regulations coming fully into force, this point was alluded to by Lloyd J in *Re Pan Atlantic Insurance Company Limited*[59] where he suggested that, although not relevant in that case ("as it is not clear that there are any creditors who are not insurance creditors"), the introduction of the RWU Regulations would have to be taken into account in relation to insurance companies with insurance and non-insurance creditors for purposes of composing classes of creditors for the scheme.[60]

A Non-defaulting Party will generally have sufficient time, following notice of the meeting of creditors to consider the scheme, to exercise its rights under the close-out netting provisions of the ISDA Master Agreement, before the scheme is approved by a specified majority of the creditors (or relevant class of creditors) and sanctioned by the court, in accordance with the requirements of the Companies Act 2006, and becomes binding on all the creditors. (It should be noted that there may be some circumstances in which it may be advantageous for a Non-defaulting Party not to close out its position prior to a scheme of arrangement being sanctioned by the court. Professional advice should always be taken when a scheme of arrangement is proposed in this context.)

We do not believe that an English court would sanction a scheme of arrangement that would prejudice non-insurance creditors. Although the Companies Act 2006 provides no guidance to the court as to what factors should guide its decision whether or not to sanction a scheme of arrangement under Part 26 of the Companies Act 2006, it is clear that the purpose of the court being required to sanction the scheme is to ensure, among other things, that the process is fair to the members of each class.

(f) Company voluntary arrangements

An English Insurance Company that is a Companies Act Company may enter into a company voluntary arrangement with its creditors under Part I of the Insolvency Act 1986, as an alternative to a scheme of arrangement under Part 26 of the Companies Act 2006. This option is not, however, available to an English Insurance Company organised as a Friendly Society, I&P Society, Statutory Corporation or Chartered Corporation for reasons given in relation to each such type of entity elsewhere in this supplemental opinion.

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57 As far as we are aware, to date there has been only one scheme of arrangement for an Insurance Company under Part 26 of the Companies Act 2006, which is a solvent scheme of arrangement for The Scottish Lion Insurance Company Limited. The explanatory statement for the scheme, which is required by section 897 of the Companies Act 2006, was issued on 22 December 2008.

58 [2003] EWHC 663 (Ch)

59 [2003] EWHC 1969 (Ch), [2003] BCC 847

60 In the *Pan Atlantic* case, Lloyd J was asked to consider the potential effect of the 2003 version of the RWU Regulations, which were repealed and replaced by the RWU Regulations in 2004. The differences between the two versions are not relevant to the point under discussion.

There are certain differences between the rules applicable to schemes of arrangement under the Companies Act 2006 and company voluntary arrangements under the Insolvency Act 1986, but they are not material to our conclusions in relation to the issues discussed in Annex 6. Company voluntary arrangements are considered not to be well-adapted for use with an English Insurance Company and are therefore relatively rare in this sector. Although section 1A of the Insolvency Act 1986 provides for a moratorium in relation to certain companies proposing to enter into a company voluntary arrangement, English Insurance Companies are expressly excluded from eligibility for the moratorium.[61]

As in the case of a scheme of arrangement, a Non-defaulting Party will generally have sufficient time, following notice of the meeting of creditors to consider the company voluntary arrangement, to exercise its rights under the close-out netting provisions of the ISDA Master Agreement, before the scheme is approved by the specified majority of the creditors as required by the Insolvency Act 1986. Court sanction is not required, but an aggrieved creditor has a limited right to challenge the company voluntary arrangement if it feels it has been unduly prejudiced or there has been a material irregularity in relation to the company voluntary arrangement.

(g) Part VII of the Financial Services and Markets Act 2000

Part VII of the Financial Services and Markets Act 2000 sets out provisions for insurance business transfer schemes.[62] An insurance business transfer scheme is a scheme under which the whole or part of the business of an English Insurance Company may be transferred to another body, subject to certain conditions and exclusions. Part VII applies to any English Insurance Company other than a Friendly Society.[63]

Under section 104 of the Financial Services and Markets Act 2000, an insurance business transfer scheme may be effected only if an order has been made by the court sanctioning the scheme under section 111(1) of the Act. Section 107 of the Act governs the making of an application for an order sanctioning the scheme. The application may be made by the English Insurance Company, the transferee or both. If the court sanctions the scheme by order under section 111(1), then certain other provisions of Part VII apply, including sections 112 and 112A.

Section 112(1)[64] sets out the powers of the court in relation to a business transfer scheme, which may be made by the court in its order under section 111(1) sanctioning the scheme or by any subsequent order, as the court thinks fit. Section 112A provides that any right of a person to terminate, modify, acquire or claim an interest or right to treat an interest or right as terminated or modified in consequence of anything done or likely to be done in connection with a scheme under Part VII is not enforceable until after the court has made its order under section 112(1) and is then enforceable only to the extent permitted by the order.

Section 112(1) gives the court broad powers to make any provision it sees fit to give effect to the transfer and to what is "necessary to secure that the scheme is fully and effectively carried out". In particular the court may provide for the transfer of any property or liabilities of the insurer without any requirement for the consent of any third party.

Accordingly, an order under section 112(1) could effectively override the right of a counterparty to an English Insurance Company to designate an Early Termination Date as

61 Paragraph 2 of Schedule A1 to the Insolvency Act 1986.
62 Part VII of the Financial Services and Markets Act 2000 also deals with banking business transfer schemes, as discussed in Annex 1 of the ISDA Netting Opinion.
63 Financial Services and Markets Act 2000, s 105(3) excludes a Friendly Society from the scope of Part VII of the Act.
64 The remainder of section 112 clarifies and, in certain respects, extends the scope of the court's power under section 112(1).

the result of an Event of Default or Termination Event under an ISDA Master Agreement that occurs as a result of something done or likely to be done in connection with an insurance business transfer scheme under Part VII.

We do not believe that an English court would make an order that would permit some, but not all, of the rights and liabilities under an ISDA Master Agreement to be transferred under an insurance business transfer scheme if the effect would be unfairly prejudicial to the other party to the ISDA Master Agreement, and therefore we do not believe that an order would be made that is inconsistent with our material conclusions in relation to the enforceability of close out netting under the ISDA Master Agreement.

There may, however, be certain circumstances in which a counterparty to the English Insurance Company is prevented from designating an Early Termination Date where it would otherwise have had the right to do so. Any such order would be limited to the carrying out of the scheme, and would likely either involve the transfer of the whole of the ISDA Master Agreement (including all rights and obligations under the ISDA Master Agreement, each Transaction and any related Credit Support Document) to the transferee or would leave the ISDA Master Agreement with the original English Insurance Company. It would not prejudice, in our view, the right of the counterparty to designate an Early Termination Date under the ISDA Master Agreement as a result of an Event of Default or Termination Event constituted by any occurrence or condition in relation to the English Insurance Company after the transfer had been effected and the terms of the order complied with.

(h) Reduction of contracts

Section 377 of the Financial Services and Markets Act 2000[65] gives the court the power to reduce the value of one or more of an insolvent English Insurance Company's contracts as an alternative to winding-up. We do not, however, believe that this power has been exercised in any significant number of cases.

Section 377 would not, in any event, appear to prevent, or give a court the power to prevent, the exercise by the Non-defaulting Party of its rights under the close-out netting provisions of the ISDA Master Agreement. A remote possibility exists that it might be used to reduce the value of a subsequent net claim under the ISDA Master Agreement if owed by the English Insurance Company. We are not aware that the power has ever been exercised in relation to the ISDA Master Agreement or any comparable financial market agreement.

(i) Valuation of policies

The Winding Up Rules[66] make provision as to the method of valuing policies of an English Insurance Company that has gone into liquidation. The resulting values are likely to reflect the amount of the reserves that an English Insurance Company should have established to meet its insurance liabilities as well as the values which would in any event have been placed on the policies under the general insolvency rules. They should therefore facilitate an assessment of the assets likely to be available at any time to meet the claims of general unsecured creditors.

[65] This provision does not apply to a Friendly Society. See note 46.
[66] The Winding Up Rules do not apply to a Friendly Society. See note 46.

(j) Compensation scheme

Under Part XV of the Financial Services and Markets Act 2000, the Financial Services Authority has established the Financial Services Compensation Scheme (**FSCS**) under which eligible persons may be compensated where authorised firms are unable, or are likely to be unable, to satisfy protected claims against them. (In the case of an English Insurance Company, the FSCS may alternatively assist by providing financial assistance to the English Insurance Company concerned or by arranging for the transfer of policies to another English Insurance Company.)

In the case of English Insurance Companies, protected claims are claims arising from risks covered by direct long-term insurance policies and (with certain exceptions) direct general insurance policies; and eligible persons are policyholders under such policies (provided that, in the case of general insurance, they are individuals or partnerships), where the risks or commitments insured under the policies are situated in the UK, or in some cases in the EEA, the Channel Islands or the Isle of Man.

The level of compensation payable by the FSCS differs according to the type of insurance policy concerned: when the insurance is compulsory (for example, third party car insurance), full compensation is paid; for non-compulsory general insurance (for example, home and contents insurance) and for long-term insurance policies, 90 per cent. of the amount of the claim is paid (calculated in accordance with Scheme rules).

The FSCS will normally be subrogated to the claims of policyholders to whom it pays compensation (including, under the RWU Regulations, their priority), so the claims of unsecured general creditors should be unaffected. However, the participation of the FSCS in a winding-up may affect (possibly expedite) the progress of winding-up proceedings to some extent.

The Insurer Administration Order imposes a duty on the administrator of an insurer to assist the FSCS in administering the compensation scheme in relation to contracts of insurance, and in securing continuity of insurance in relation to contracts of long-term insurance.

(k) Banking Act 2009 – exclusion of insurers

On 21 February 2009 the Banking Act 2009 entered into force, introducing, among other things, a special resolution regime in relation to UK banks and building societies. Although the Banking Act 2009 was apparently not intended to apply to English Insurance Companies, any English Insurance Company with permission under Part 4 of the Financial Services and Markets Act 2000 to carry on the regulated activity of accepting deposits falls within the definition of "bank" in section 2(1) of the Banking Act 2009 and is therefore *prima facie* within its scope.[67] In our experience, most English Insurance Companies have permission to accept deposits. Section 2(2)(c) of the Banking Act 2009 gives the Treasury the power to exclude a class of institutions from the definition of "bank". The Treasury exercised this power, by an order[68] that came into force on 7 January 2010, to exclude any institution with permission under Part 4 of the Financial Services and Markets Act 2000 to effect or carry out contracts of insurance as principal. Therefore the Banking Act 2009 does not apply to any English Insurance Company falling within the scope of this supplemental opinion.

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67 "Bank" is defined in section 2(1) of the Banking Act 2009 as "a UK institution which has permission under Part 4 of the Financial Services and Markets Act 2000 to carry on the regulated activity of accepting deposits". A "UK institution" is defined in section 2(3) of the Banking Act 2009 as "an institution which is incorporated in, or formed under the law of any part of, the United Kingdom".

68 The Banking Act 2009 (Exclusion of Insurers) Order 2010 SI 2010/35.

2.3 *Regulatory provisions*

The Financial Services Authority enjoys wide powers under the Financial Services and Markets Act 2000 to make rules applicable to authorised firms (including English Insurance Companies) and to supervise their businesses, including power to impose individual requirements on an English Insurance Company where there has been a breach of rules or there is a perceived threat to the interests of its policyholders. While it is unlikely that the Financial Services Authority would exercise its powers in such a way as to prejudice directly the interests of non-insurance creditors, it may be that an exercise of their powers could in certain circumstances affect the ability of an English Insurance Company to comply with its obligations under the ISDA Master Agreement, as mentioned below.

(a) <u>Separation of long-term insurance business</u>

The provisions in the RWU Regulations relating to non-transferring Composites which are direct insurance undertakings substantially reflect requirements of the Financial Services Authority relating to the ongoing supervision of English Insurance Companies that carry on long-term insurance business. In our view those requirements will continue to apply to an insurer in liquidation or provisional liquidation which is a "transferring insurer", that is, its long-term business being carried on with a view to its being transferred to another company, including in the case of a Composite, in circumstances where the liquidator or provisional liquidator causes the insurer to continue its business prior to such transfer.[69]

Any such English Insurance Company is required, under INSPRU 1.5.23, to maintain an account and separate fund in respect of that business. The receipts of that business (premiums and investment income) and the assets representing those receipts must be carried to and form a fund (known as the "long-term insurance fund") separate from all the other assets of the English Insurance Company. This requirement applies so as to require the assets of the long-term insurance fund to be separated not only from assets employed in the general business (in the case of a Composite, whether transferring or non-transferring) but also (whether or not the English Insurance Company is a Composite) from assets employed for other purposes of the English Insurance Company (commonly referred to as "shareholders' funds").[70]

Furthermore, under INSPRU 1.5.30, the assets of a long-term insurance fund will normally not be available to discharge any claim of a creditor of the English Insurance Company that arises from a Transaction not entered into for the purposes of the long-term insurance business. Accordingly, in the case of Transactions with a Life Insurance Company or Composite (whether transferring or non-transferring):

(i) it would be a breach of INSPRU 1.5.30 for an English Insurance Company to permit the netting of Transactions entered into in connection with the English Insurance Company's long-term insurance business against Transactions entered into in accordance with its other business, and such mingling of Transactions should be avoided; and

(ii) it will normally be desirable to ensure that Transactions are all, in fact, entered into with the English Insurance Company's long-term insurance business, since the preponderance of the English Insurance Company's assets are likely to be held in its long-term insurance fund.

69 Where the liquidator or provisional liquidator does not cause the Composite to continue its business, but instead realises the assets to make a distribution to creditors, the RWU Regulations referred to above will apply.

70 The above requirements may continue to apply to a Life Insurance Company or Composite in liquidation or provisional liquidation which is a "transferring insurer", that is, where its long-term insurance business is being carried on with a view to its being transferred to another company.

The implication of this is that, in order for the ISDA Master Agreement to be for the purpose of the long-term insurance business, the Transactions to which they relate must also be for such purpose. We think that, provided that the Transactions themselves are legal, valid, binding and enforceable and are being entered into in order to hedge an exposure in relation to the long-term insurance fund, the entry into of the ISDA Master Agreement could be viewed as for the purpose of the long-term insurance fund to the extent that it supports such Transactions.

Section 151(2) of the Financial Services and Markets Act 2000 provides that no contravention of a rule made by the Financial Services Authority makes any Transaction void or unenforceable. Accordingly, we consider that any breach of INSPRU 1.5.30 would not prevent the counterparty from taking proceedings to enforce the ISDA Master Agreement against the English Insurance Company, including proceedings to enforce the netting provisions in the ISDA Master Agreement. We also consider that such a breach would not prevent the English Insurance Company from taking enforcement proceedings against the counterparty. It also seems unlikely that the Financial Services Authority's supervisory powers could be used so as to affect the validity of an agreement entered into in breach of the rules.

Accordingly, the concern of any potential counterparty as to a breach of the rules is likely to be confined to the possibility that such a breach will result in action by the Financial Services Authority which would curtail the income or capitalisation of the English Insurance Company or affect the reputational standing of the English Insurance Company or the counterparty. However, as a result of the practical implications which any requirements imposed upon the English Insurance Company by the Financial Services Authority may have, including any disciplinary action which they might take, as the consequence of a breach of INSPRU 1.5.30, we recommend that a party obtain a representation from the English Insurance Company that each Transaction entered into with the English Insurance Company is for the purposes of its long-term insurance business.

To the extent that a party is dealing with an English Insurance Company that is a Life Insurance Company or Composite that uses assets other than long-term insurance business assets, we recommend that separate ISDA Master Agreements are entered into in relation to the long-term business and the general business. In this way Transactions relating to long-term insurance business are governed by one ISDA Master Agreement and Transactions relating to general business are governed by a separate ISDA Master Agreement. This should minimise the risk that the assets of different funds are mixed and the risk that INSPRU 1.5.30 is breached.

Please note that INSPRU 1.5.30 deals with long-term insurance business assets. It does not apply to any other assets of the relevant English Insurance Company. This means that, to the extent that an English Insurance Company used other assets, INSPRU 1.5.30 would not be relevant to the operation of the ISDA Master Agreement although INSPRU 1.5.13/1.5.13A, discussed below, still would be.

A final point to note is that if a Transaction is not entered into for the purpose of the English Insurance Company's long-term insurance business (which is unlikely for the reasons given above) and consequently there has been a breach of the representation suggested above, then the representation may be of limited value to the other party if the English Insurance Company has, in fact, few assets outside its long-term insurance business fund with which to make good the breach.

(b) Insurance business limitation

INSPRU 1.5.13 and 1.5.13A are designed to inhibit English Insurance Companies from entering into business other than insurance business, due to a concern that any such other business may fail and bring down the insurance business with it.

INSPRU 1.5.13 provides as follows:

> "A firm [that is, an insurer] other than a pure reinsurer must not carry on any commercial business other than insurance business[71] and activities directly arising from that business."

INSPRU 1.5.13A then provides that:

> "A pure reinsurer must not carry on any business other than the business of reinsurance and related operations."

The scope of INSPRU 1.5.13 and 1.5.13A should be noted as they apply to activities wherever carried on. This means that even if performance under the ISDA Master Agreement occurs outside the United Kingdom, INSPRU 1.5.13 and 1.5.13A will still be relevant.

Two questions arise from this provision. First, would the entering into of derivative transactions by an English Insurance Company be regarded as an activity "directly arising from" insurance business or, in the case of a pure reinsurer, would it be regarded as a "related operation"? Secondly, if an English Insurance Company enters into derivative transactions in breach of INSPRU 1.5.13 or 1.5.13A, what would be the effect on the transaction and the rights of a counterparty?

There is no meaning attributed to "directly arising from" in INSPRU. However, it seems to us that the phrase should encompass all activities undertaken by an English Insurance Company for the purposes of enabling it to carry out its obligations under contracts of insurance which it has written and that this will include the investment of funds received in the course of its insurance business. There is strong authority from the taxation field to the effect that the investment of funds received by an English Insurance Company will form part and parcel of its insurance business.[72]

More specifically, support for the view that English Insurance Companies may properly enter into derivative contracts such as the Transactions in relation to their insurance business is given by INSPRU 3.2. This clearly envisages English Insurance Companies entering into derivative contracts and provides guidance on the admissibility of those contracts for regulatory valuation purposes. It does not, however, expressly state that English Insurance Companies can enter into the Transactions or agreements similar to the ISDA Master Agreement.

Based on this, we think that an English Insurance Company could enter into the Transactions in appropriate circumstances. Broadly, we think that Transactions would be entered into in appropriate circumstances if entered into for the purposes of efficient portfolio management or the reduction of investment risk in compliance with the requirements of INSPRU 3.2 in relation to the English Insurance Company's long-term insurance business and are likely to be treated as "directly arising" from its insurance business for the purposes of INSPRU 1.5.13 or as "related operations" for the purposes of INSPRU 1.5.13A.

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71 That is, the business of effecting or carrying out contracts of insurance as principal.
72 See *Liverpool and London Globe Insurance Company v Bennett* [1913] AC 610 at 621 (opinion of Lord Mersey).

As discussed under (a) above, section 151(2) of the Financial Services and Markets Act 2000 provides that a contravention of rules made by the Financial Services Authority will not make a Transaction void or unenforceable. Accordingly, we consider that, as in the case of INSPRU 1.5.30, any breach of INSPRU 1.5.13 or 1.5.13A would not prevent the counterparty from taking proceedings to enforce the ISDA Master Agreement against the English Insurance Company, including proceedings to enforce the netting provisions in the ISDA Master Agreement. We also consider that such a breach would not prevent the English Insurance Company from taking enforcement proceedings against the counterparty. It also seems unlikely that the Financial Services Authority's supervisory powers could be used so as to affect the validity of an agreement entered into in breach of the rules.

Accordingly, the concern of any potential counterparty as to a breach of the rules is likely to be confined to the possibility that such a breach will result in action by the Financial Services Authority which would curtail the income or capitalisation of the English Insurance Company or that it may affect the reputational standing of the English Insurance Company or, conceivably, the counterparty. However, as a result of the practical implications which any requirements imposed upon the English Insurance Company by the Financial Services Authority may have, including any disciplinary action which they might take, as the consequence of a breach of INSPRU 1.5.13 or 1.5.13A, we recommend that a party obtain a representation from the English Insurance Company that Transactions entered into with the English Insurance Company constitute activities directly arising from insurance business.

(c) Own-initiative powers

The supervisory powers of the Financial Services Authority include powers (known as "own-initiative powers") under section 45 of the Financial Services and Markets Act 2000 to (i) vary or cancel an English Insurance Company's Part IV permission or (ii) cancel, impose or vary requirements upon it to take or refrain from taking specified action if it appears to the Financial Services Authority that the English Insurance Company is failing or is likely to fail to meet the threshold conditions specified in Schedule 6 to the Financial Services and Markets Act 2000 (which include conditions as to the adequacy of its resources and its suitability), or has failed for 12 months to carry on a regulated activity for which it has a Part IV permission, or that it is desirable to intervene in order to protect the interests of consumers or potential consumers. The Financial Services Authority may also, under section 46 of the Financial Services and Markets Act 2000, impose or vary requirements on an English Insurance Company where there has been a change in any of its controllers and the likely effect of the change of control on the English Insurance Company or any of its activities is uncertain.

In our view it is unlikely that the Financial Services Authority's powers under the above provisions could be employed so as to require an English Insurance Company to take action which would directly interfere with the operation of any existing Transaction and therefore it is unlikely that it could be employed to affect the operation of the ISDA Master Agreement. The powers could, in some circumstances, be employed so as to require the English Insurance Company not to enter into future Transactions.

However, in any event, acting outside its permission or otherwise breaching a Financial Services Authority requirement would not affect the validity of any Transaction subsequently entered into by the English Insurance Company, and consequently the ISDA Master Agreement, because section 20(2)(b) of the Financial Services and Markets Act 2000 expressly provides that such a breach will not make any Transaction void or unenforceable. Nevertheless, it is possible that other consequences of the breach (for example, any disciplinary fine which might be imposed upon the English Insurance Company) might indirectly affect the English Insurance Company's ability to meet its obligations under the Transactions or the ISDA Master Agreements or could cause some reputational damage to the counterparty. We think, therefore, that it is unlikely that a party would enter into any further Transactions with the relevant English Insurance Company in these circumstances.

2.4 *Close-out netting against an English Insurance Company subject to insolvency proceedings*

We set out below our conclusions in relation to the enforceability of close-out netting against an English Insurance Company established in any of the legal forms falling within the scope of this supplemental opinion. For the reasons discussed above, for the purposes of our conclusions below we assume that all Transactions between a party and an English Insurance Company under the ISDA Master Agreement are entered into for the purposes of either (i) the long-term insurance business of the English Insurance Company (in the case of an English Insurance Company that carries on long-term business) or (ii) its other businesses (if any), and not a mixture of both.

(a) Winding up

If an English Insurance Company were subject to winding up under the rules that would normally apply to an English Insurance Company established in its relevant legal form, then, in our view, the close-out netting provisions of the ISDA Master Agreement would be enforceable against that English Insurance Company for the reasons we give in part III.3(3)(a) of the ISDA Netting Opinion in relation to an English Company on the basis that the close-out netting provisions of the ISDA Master Agreement do not involve contractual set-off (other than to the limited extent that it includes Unpaid Amounts due from the Defaulting Party, as discussed in the ISDA Netting Opinion) but simply represent an accounting of rights and liabilities under a single agreement following the designation or deemed occurrence of an Early Termination Date (sometimes referred to as the "flawed asset" approach to close out netting).

If, however, the court were to construe the close-out netting provisions of the ISDA Master Agreement as operating by way of contractual set-off rather than pursuant to the single agreement (or "flawed asset") approach described above, we also consider that the close-out netting provisions of the ISDA Master Agreement would be enforceable against the English Insurance Company for the reasons set out in part III.3(3)(a) of the ISDA Netting Opinion in relation to an English Company.

(b) Administration

If an English Insurance Company, other than a Friendly Society (which cannot be made subject to administration proceedings), were to enter into administration proceedings, the close-out netting provisions of the ISDA Master Agreement would be enforceable against that English Insurance Company on the same basis as the close-out netting provisions would be enforceable against an English Company, as set out in part III.3(3)(b) of the ISDA Netting Opinion.

(c) Company voluntary arrangement

If an English Insurance Company that is a Companies Act Company were to enter into a company voluntary arrangement under Part I of the Insolvency Act 1986, the close-out netting provisions of the ISDA Master Agreement would be enforceable against that English Insurance Company on the same basis as the close-out netting provisions would be enforceable against an English Company, as set out in part III.3(3)(c) of the ISDA Netting Opinion.

(d) Scheme of arrangement

If an English Insurance Company were to enter into a scheme of arrangement under Part 26 of the Companies Act 2006, the close-out netting provisions of the ISDA Master Agreement would be enforceable against the English Insurance Company on the same basis as the close-out netting provisions would be enforceable against an English Company, as set out in part III.3(3)(d) of the ISDA Netting Opinion.

ANNEX 7

ENGLISH CHARITY

Trustee of an English Charitable Trust

In this Annex 7, we set out our views on the enforceability of the close-out netting provisions of the ISDA Master Agreement against the Trustee of an English Charitable Trust in the event that insolvency proceedings are commenced in England in respect of the Trustee or a Trust Insolvency occurs in relation to the English Charitable Trust.

1. Conclusion

On the basis of the assumptions and subject to the qualifications in part III of the ISDA Netting Opinion as modified and supplemented by this supplemental opinion, including Annex 1 and this Annex 7, we are of the view that our conclusions in part III.3 of the ISDA Netting Opinion would apply to a Trustee of an English Charitable Trust in the event that insolvency proceedings are commenced in England in respect of the Trustee or a Trust Insolvency occurs in respect of the English Charitable Trust.

2. Analysis

2.1 *Application of general trust law to English Charitable Trusts*

This Annex 7 should be read together with the analysis of Trustees and English Trusts elsewhere in this supplemental opinion, in particular in part 2.1, Appendix II and Annex 1. That analysis applies to the Trustee of an English Charitable Trust, as supplemented by this Annex 7.

2.2 *Investment manager for the Trustee of an English Charitable Trust*

It is common for the Trustee of an English Charitable Trust to appoint an investment manager to act as agent for the Trustee for certain purposes. In such a case, a party would enter into an ISDA Master Agreement, and each Transaction under that ISDA Master Agreement, with an investment manager acting as agent for the Trustee of the English Charitable Trust rather than directly with the Trustee. The investment manager will have been appointed by the Trustee pursuant to a power to do so in the trust deed for the English Charitable Trust, and subject to any applicable requirements of the trust deed. The terms of the investment manager's appointment and the scope of its authority as agent will be determined by an investment management agreement between the investment manager and the Trustee.

Provided that the investment manager has been validly appointed and is acting within the scope of its authority in entering into an ISDA Master Agreement and each Transaction with a party, and in performing any obligations of the Trustee on behalf of the English Charitable Trust, then the ISDA Master Agreement will be a contractual relationship between the party and the Trustee directly. A failure by the investment manager to perform an obligation of the Trustee under the ISDA Master Agreement or any Transaction will constitute a failure to perform by the Trustee in just the same manner as if the Trustee had been dealing directly with the party.

The commencement of insolvency proceedings in relation to the investment manager will normally effect a revocation of its authority to act as agent of the Trustee or to continue to perform the obligations of the Trustee after the effective date of such revocation, but will not otherwise affect the enforceability of the ISDA Master Agreement or any Transaction against the Trustee.

Our analysis of the enforceability of the close-out netting provisions of the ISDA Master Agreement against the Trustee of an English Charitable Trust is not affected by whether the Trustee has entered into the ISDA Master Agreement or any Transaction directly with the other party or through an investment manager acting as agent. Therefore we do not need to give further consideration to the role of the investment manager in this Annex 7.

2.3 *Close-out netting against a Trustee of an English Charitable Trust*

Our conclusions in part III.3 of the ISDA Netting Opinion would apply to a Trustee of an English Charitable Trust in the event that insolvency proceedings are commenced in England in respect of the Trustee or a Trust Insolvency occurs in respect of the English Charitable Trust for the reasons given in Annex 1. In other words, the special regulatory regime that applies to an English Charitable Trust under the Charities Act 2006 has no material effect on the analysis and conclusions in Annex 1.

ANNEX 8

ENGLISH CHARITY

Other forms of English Charity

In this Annex 8, we set out our views on the enforceability of the close-out netting provisions of the ISDA Master Agreement against an English Charity other than a Trustee of an English Charitable Trust in the event that insolvency proceedings are commenced in England in respect of the English Charity.

The types of insolvency proceeding that may be commenced in England in respect of an English Charity are, in respect of an English Charity established as:

(a) a Companies Act Company, set out in part III.1(4) of the ISDA Netting Opinion;

(b) a Friendly Society, set out in Annex 2;

(c) an I&P Society, set out in Annex 3;

(d) a Statutory Corporation, set out in Annex 4; and

(e) a Chartered Corporation, set out in Annex 5.

1. Conclusion

On the basis of the assumptions and subject to the qualifications in part III of the ISDA Netting Opinion as modified and supplemented by this supplemental opinion, including this Annex 8, we are of the view that our conclusions in part III.3 of the ISDA Netting Opinion would apply to an English Charity in the event that insolvency proceedings are commenced in England in respect of the English Charity.

2. Analysis

2.1 *Investment manager for the English Charity*

It is common for an English Charity to appoint an investment manager to act as agent for the English Charity for certain purposes. In such a case, a party would enter into an ISDA Master Agreement, and each Transaction under that ISDA Master Agreement, with an investment manager acting as agent for the English Charity rather than directly with the English Charity. The terms of the investment manager's appointment and the scope of its authority as agent will be determined by an investment management agreement between the investment manager and the English Charity.

Provided that the investment manager has been validly appointed and is acting within the scope of its authority in entering into an ISDA Master Agreement and each Transaction with a party, and in performing any obligations of the English Charity, then the ISDA Master Agreement will be a contractual relationship between the party and the English Charity directly. A failure by the investment manager to perform an obligation of the English Charity under the ISDA Master Agreement or any Transaction will constitute a failure to perform by the English Charity in just the same manner as if the English Charity had been dealing directly with the party.

The commencement of insolvency proceedings in relation to the investment manager will normally effect a revocation of its authority to act as agent of the English Charity or to continue to perform the obligations of the English Charity after the effective date of such revocation, but will not otherwise affect the enforceability of the ISDA Master Agreement or any Transaction against the English Charity.

Our analysis of the enforceability of the close-out netting provisions of the ISDA Master Agreement against an English Charity is not affected by whether the English Charity has entered into the ISDA Master Agreement or any Transaction directly with the other party or through an investment manager acting as agent. Therefore we do not need to give further consideration to the role of the investment manager in this Annex 8.

2.2 *Insolvency proceedings against an English Charity*

Although the charitable sector is heavily regulated, the insolvency proceedings applicable to an English Charity are determined by its legal form. In contrast to the insurance sector, there are no special insolvency rules that apply to an English Charity under charities law or that modify the rules that would otherwise apply to the English Charity.

2.3 *Close-out netting against an English Charity*

It follows from 2.2 above that the close-out netting provisions of the ISDA Master Agreement would be enforceable against an English Charity established as:

(a) a Companies Act Company, for the reasons set out in part III.3 of the ISDA Netting Opinion;

(b) a Friendly Society, for the reasons set out in Annex 2;

(c) an I&P Society, for the reasons set out in Annex 3;

(d) a Statutory Corporation, for the reasons set out in Annex 4; and

(e) a Chartered Corporation, for the reasons set out in Annex 5.

ANNEX 9

ENGLISH INVESTMENT FUND

Open-Ended Investment Company

In this Annex 9, we set out our views on the enforceability of the close-out netting provisions of the ISDA Master Agreement against an Open-Ended Investment Company in the event that insolvency proceedings are commenced in England in respect of the Open-Ended Investment Company.

Subject to the more detailed discussion below, the types of insolvency proceeding that may be commenced in England in respect of an Open-Ended Investment Company are, pursuant to regulation 31 of the OEIC Regulations, a voluntary or compulsory winding under the Insolvency Act 1986. It is also possible that an Open-Ended Investment Company could be made subject to a scheme of arrangement under Part 26 of the Companies Act 2006.

1. Conclusion

On the basis of the assumptions and subject to the qualifications in part III of the ISDA Netting Opinion as modified and supplemented by this supplemental opinion, including this Annex 9, we are of the view that our conclusions in part III.3 of the ISDA Netting Opinion would apply to an Open-Ended Investment Company in the event that insolvency proceedings are commenced in England in respect of the Open-Ended Investment Company.

2. Analysis

2.1 *UCITS authorised schemes, non-UCITS retail schemes and qualified investor schemes*

An Open-Ended Investment Company is a collective investment scheme for purposes of Part XVII (sections 235 – 284) of the Financial Services and Markets Act 2000. Under section 262 of the Act, the Treasury was given the power to make the OEIC Regulations. Under regulation 6 of the OEIC Regulations, the Financial Services Authority was given authority to make rules for Open-Ended Investment Companies. This power has been exercised and the relevant rules can be found in the Collective Investment Schemes Sourcebook (**COLL**). The rules in COLL distinguish between various categories of collective investment scheme. An Open-Ended Investment Company might, therefore, be a UCITS authorised scheme (that is, subject to rules consistent with the UCITS Directive[73]), a non-UCITS retail scheme or a non-retail scheme (otherwise known as a "qualified investor scheme").

Our conclusions regarding the enforceability of the ISDA Master Agreement against an Open-Ended Investment Company, both in the absence of insolvency proceedings (as confirmed in part 4 of the supplemental opinion) and in the event that insolvency proceedings are commenced in England in respect of the Open-Ended Investment Company are not affected by whether the Open-Ended Investment Company is a UCITS authorised scheme, non-UCITS retail scheme or a non-retail scheme (qualified investor scheme).

2.2 *Authorised corporate director or investment manager for the Open-Ended Investment Company*

Regulation 15 of the OEIC Regulations provides, among other things, that an Open-Ended Investment Company must have at least one director and, if it has a single director, the single director must be a body corporate which is an authorised person with permission under Part IV of the

73 Directive 2001/108/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS).

Financial Services and Markets Act 2000 to act as sole director of an Open-Ended Investment Company. This director is known as the authorised corporate director (**ACD**) of the Open-Ended Investment Company. Under COLL a Open-Ended Investment Company is expected to have at all times an appropriately qualified ACD, even if it has more than one director.[74]

In practice, it is likely that a party will enter into an ISDA Master Agreement, and each Transaction under that ISDA Master Agreement, with the ACD acting as agent for the Open-Ended Investment Company or with an investment manager appointed by the ACD acting as agent for the Open-Ended Investment Company.

In relation to dealing with the ACD, the same considerations apply as when dealing with the director, officer or other representative of any company, namely, whether the director, officer or other representative has the appropriate authority to act on behalf of the company when entering into an agreement such as the ISDA Master Agreement. As discussed in part 2.3 of this supplemental opinion, we have assumed, among other things, that the persons entering into the ISDA Master Agreement on behalf of each party have the necessary authority. When a party enters into an ISDA Master Agreement and each Transaction under the ISDA Master Agreement with the duly authorised ACD acting on behalf of an Open-Ended Investment Company, then the party is in a direct contractual relationship with the Open-Ended Investment Company.

In relation to dealing with an investment manager, the investment manager will have been appointed by the ACD. The terms of the investment manager's appointment and the scope of its authority as agent will be determined by an investment management agreement between the investment manager and the Open-Ended Investment Company.

Provided that the investment manager has been validly appointed and is acting within the scope of its authority in entering into an ISDA Master Agreement and each Transaction with a party, and in performing any obligations of the Open-Ended Investment Company, then the ISDA Master Agreement will be a contractual relationship between the party and the Open-Ended Investment Company directly. A failure by the investment manager to perform an obligation of the Open-Ended Investment Company under the ISDA Master Agreement or any Transaction will constitute a failure to perform by the Open-Ended Investment Company in just the same manner as if the Open-Ended Investment Company had been dealing directly with the party.

The commencement of insolvency proceedings in relation to the investment manager will normally effect a revocation of its authority to act as agent of the Open-Ended Investment Company or to continue to perform the obligations of the Open-Ended Investment Company after the effective date of such revocation, but will not otherwise affect the enforceability of the ISDA Master Agreement or any Transaction against the Open-Ended Investment Company.

Our analysis of the enforceability of the close-out netting provisions of the ISDA Master Agreement against an Open-Ended Investment Company is not affected by whether the Open-Ended Investment Company has entered into the ISDA Master Agreement or any Transaction directly with the other party or through an investment manager acting as agent. Therefore we do not need to give further consideration to the role of the investment manager in this Annex 9.

2.3 *Insolvency proceedings in respect of an Open-Ended Investment Company*

Regulation 31 of the OEIC Regulations provides that an Open-Ended Investment Company may be wound up as an unregistered company under Part V of the Insolvency Act 1986, subject to certain modifications that are not relevant to the issues we are considering in this Annex 9. Whether the winding up of an Open-Ended Investment Company is conducted on a voluntary or compulsory

74 COLL 6.5.3.

basis, the provisions of the Insolvency Rules 1986 relevant to a winding up will apply to the winding up of the Open-Ended Investment Company, including the insolvency set-off provision in Rule 4.90.

An Open-Ended Investment Company may not be made subject to a company voluntary arrangement or to administration proceedings under the Insolvency Act 1986. Each of these regimes is limited to Companies Act Companies and certain foreign companies. [75]

It is possible that an Open-Ended Investment Company could be made subject to a scheme of arrangement under Part 26 of the Companies Act 2006 for the reasons given in paragraph 3.4 of Annex 4 to the ISDA Netting Opinion in relation to Standard Chartered Bank, which is a Chartered Corporation. The same arguments as apply in relation to a Chartered Corporation would arguably also apply in relation to an Open-Ended Investment Company.

2.4 *Close-out netting against an Open-Ended Investment Company*

If an Open-Ended Investment Company were, pursuant to regulation 31 of the OEIC Regulations, wound up as an "unregistered company" under section 221 of the Insolvency Act 1986, then, in our view, the close-out netting provisions of the ISDA Master Agreement would be enforceable against that Open-Ended Investment Company for the reasons we give in part III.3(3)(a) of the ISDA Netting Opinion in relation to an English Company on the basis that the close-out netting provisions of the ISDA Master Agreement do not involve contractual set-off (other than to the limited extent that it includes Unpaid Amounts due from the Defaulting Party, as discussed in the ISDA Netting Opinion) but simply represent an accounting of rights and liabilities under a single agreement following the designation or deemed occurrence of an Early Termination Date (sometimes referred to as the "flawed asset" approach to close-out netting).

If, however, the court were to construe the close-out netting provisions of the ISDA Master Agreement as operating by way of contractual set-off rather than pursuant to the single agreement (or "flawed asset") approach described above, we also consider that the close-out netting provisions of the ISDA Master Agreement would be enforceable against the Open-Ended Investment Company for the reasons set out in part III.3(3)(a) of the ISDA Netting Opinion in relation to an English Company.

If an Open-Ended Investment Company were to enter into a scheme of arrangement under Part 26 of the Companies Act 2006, the close-out netting provisions of the ISDA Master Agreement would be enforceable against the Open-Ended Investment Company on the same basis as the close-out netting provisions would be enforceable against an English Company, as set out in part III.3(3)(d) of the ISDA Netting Opinion.

[75] In relation to company voluntary arrangements, see the definition of "company" in section 1(4) of the Insolvency Act 1986, and in relation to administration proceedings, see the definition of "company" in paragraph 111(1A) of Schedule B1 to the Insolvency Act 1986.

ANNEX 10

ENGLISH INVESTMENT FUND

Trustee of an Authorised Unit Trust

In this Annex 10, we set out our views on the enforceability of the close-out netting provisions of the ISDA Master Agreement against the Trustee of an Authorised Unit Trust in the event that insolvency proceedings are commenced in England in respect of the Trustee or a Trust Insolvency occurs in respect of the Authorised Unit Trust.

1. Conclusion

On the basis of the assumptions and subject to the qualifications in part III of the ISDA Netting Opinion as modified and supplemented by this supplemental opinion, including Annex 1 and this Annex 10, we are of the view that our conclusions in part III.3 of the ISDA Netting Opinion would apply to a Trustee of an Authorised Unit Trust in the event that insolvency proceedings are commenced in England in respect of the Trustee or a Trust Insolvency occurs in respect of the Authorised Unit Trust.

2. Analysis

2.1 *Application of general trust law to Authorised Unit Trusts*

This Annex 10 should be read together with the analysis of Trustees and English Trusts elsewhere in this supplemental opinion, in particular in part 2.1, Appendix II and Annex 1. That analysis applies to the Trustee of an Authorised Unit Trust, as supplemented by this Annex 10.

2.2 *UCITS authorised schemes, non-UCITS retail schemes and qualified investor schemes*

An Authorised Unit Trust is a collective investment scheme for purposes of Part XVII (sections 235 – 284) of the Financial Services and Markets Act 2000. Under section 247 of the Act, the Financial Services Authority was given authority to make rules for Authorised Unit Trusts. This power has been exercised and the relevant rules can be found in the Collective Investment Schemes Sourcebook (**COLL**). The rules in COLL distinguish between various categories of collective investment scheme. An Authorised Unit Trust might, therefore, be a UCITS authorised scheme (that is, subject to rules consistent with the UCITS Directive[76]), a non-UCITS retail scheme or a non-retail scheme (otherwise known as a "qualified investor scheme").

Our conclusions regarding the enforceability of the ISDA Master Agreement against a Trustee of an Authorised Unit, both in the absence of insolvency proceedings (as confirmed in part 4 of the supplemental opinion) and in the event that insolvency proceedings are commenced in England in respect of the Trustee or a Trust Insolvency occurs in respect of the Authorised Unit Trust, are not affected by whether the Authorised Unit Trust is a UCITS authorised scheme, non-UCITS retail scheme or a non-retail scheme (qualified investor scheme).

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[76] Directive 2001/108/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS).

2.3 *Investment manager for the Trustee of an Authorised Unit Trust*

In practice, it is likely that a party will enter into an ISDA Master Agreement, and each Transaction under that ISDA Master Agreement, with an investment manager acting as agent for the Trustee of an Authorised Unit Trust rather than directly with the Trustee. The investment manager will have been appointed by the Trustee pursuant to a power to do so in the trust deed for the Authorised Unit Trust, and subject to any applicable requirements of the trust deed. The terms of the investment manager's appointment and the scope of its authority as agent will be determined by an investment management agreement between the investment manager and the Trustee.

Provided that the investment manager has been validly appointed and is acting within the scope of its authority in entering into an ISDA Master Agreement and each Transaction with a party, and in performing any obligations of the Trustee on behalf of the Authorised Unit Trust, then the ISDA Master Agreement will be a contractual relationship between the party and the Trustee directly. A failure by the investment manager to perform an obligation of the Trustee under the ISDA Master Agreement or any Transaction will constitute a failure to perform by the Trustee in just the same manner as if the Trustee had been dealing directly with the party.

The commencement of insolvency proceedings in relation to the investment manager will normally effect a revocation of its authority to act as agent of the Trustee or to continue to perform the obligations of the Trustee after the effective date of such revocation, but will not otherwise affect the enforceability of the ISDA Master Agreement or any Transaction against the Trustee.

Our analysis of the enforceability of the close-out netting provisions of the ISDA Master Agreement against the Trustee of an Authorised Unit Trust is not affected by whether the Trustee has entered into the ISDA Master Agreement or any Transaction directly with the other party or through an investment manager acting as agent. Therefore we do not need to give further consideration to the role of the investment manager in this Annex 10.

2.4 *Close-out netting against a Trustee of an Authorised Unit Trust*

Our conclusions in part III.3 of the ISDA Netting Opinion would apply to a Trustee of an Authorised Unit Trust in the event that insolvency proceedings are commenced in England in respect of the Trustee or a Trust Insolvency occurs in respect of the Authorised Unit Trust for the reasons given in Annex 1. In other words, the special regulatory regime that applies to an Authorised Unit Trust under the Financial Services and Markets Act 2000 has no material effect on the analysis and conclusions in Annex 1.

ANNEX 11

BANK OF ENGLAND

In this Annex 11, we set out our views on the enforceability of the close-out netting provisions of the ISDA Master Agreement against the Bank of England.

The Bank of England is a Chartered Corporation, having been established by a royal charter granted on 27 July 1694. The charter was supplemented by the Bank of England Act 1694 and has subsequently been amended and updated. It acts as the Central Bank of the United Kingdom and therefore was established for and continues to serve a unique and important public purpose.

Although a Chartered Corporation would normally be liable to be wound up as an unregistered company under Part V of the Insolvency Act 1986, there is good authority for the view that a statutory corporation established under a public general Act of Parliament is not liable to be wound up as an unregistered company under the Insolvency Act 1986.[77] We believe that this authority would be followed in relation to the Bank of England notwithstanding its status as a Chartered Corporation rather than a statutory corporation established under a public general Act of Parliament.

We have already confirmed in part 4 of this supplemental opinion that our conclusion in part V.3 of the ISDA Netting Opinion applies in relation to each Counterparty falling within the scope of this supplemental opinion. That conclusion, therefore, applies to the Bank of England.

If we are wrong and that an English court would wind up the Bank of England as an unregistered company, then the close-out netting provisions of the ISDA Master Agreement would in any event be enforceable against the Bank of England in such a case for the reasons given in Annex 5.

The Bank of England is a separate legal person from the Crown and therefore does not share in the sovereign immunity of the Crown.

Although not strictly speaking a legal issue, given the Bank of England's unique nature as the Central Bank of the United Kingdom, it is fair to point out that there is potentially a degree of political risk in dealing with the Bank of England that may be considered, relatively speaking, higher than in dealing with a private sector English Bank. Broadly the considerations that would be relevant are those discussed in Annex 12 in relation to the United Kingdom acting through Her Majesty's Treasury.

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[77] See note 37.

ANNEX 12

UNITED KINGDOM ACTING THROUGH HER MAJESTY'S TREASURY

In this Annex 12, we set out our views on the enforceability of the close-out netting provisions of the ISDA Master Agreement against the United Kingdom (the **Crown**) acting through Her Majesty's Treasury.

Under section 5 of and Schedule 1 to the Interpretation Act 1978, "[t]he Treasury" means the Commissioners of Her Majesty's Treasury. The Treasury is a department of the government of the United Kingdom without separate legal personality. As such, an ISDA Master Agreement entered into between a Counterparty and the Treasury constitutes an agreement between the Counterparty and the Crown.

As far as English law is concerned, there is no insolvency regime for the Crown or for the Treasury as a department of the Crown. In other words, it is not possible to institute formal insolvency proceedings against the Crown or against the Treasury in any English court. We are not aware of any jurisdiction that would apply its domestic insolvency regime to its own sovereign or would purport to apply it to a foreign sovereign, but even if there were such a jurisdiction, an English court would not recognise the effect of any foreign insolvency proceedings purportedly instituted against the Crown or the Treasury.

Accordingly, it is not necessary to consider the questions in part III of the ISDA Netting Opinion in relation to the Crown acting through the Treasury.

We have already confirmed in part 4 of this supplemental opinion that our conclusion in part V.3 of the ISDA Netting Opinion applies in relation to each Counterparty falling within the scope of this supplemental opinion. That conclusion, therefore, applies to the Crown acting through the Treasury.

Without prejudice to the foregoing, an ISDA member contemplating entering into an ISDA Master Agreement with the Crown acting through the Treasury may wish to bear the following additional points in mind:

1. *Sovereign immunity*

   In relation to a Sovereign, the question naturally arises as to whether the Sovereign enjoys immunity from jurisdiction or immunity from execution. The considerations below apply to actions against the Crown in an English court.[78]

   (e) Immunity from jurisdiction

   In the United Kingdom, the principle that civil proceedings may be instituted against the Crown was established by the Crown Proceedings Act 1947, and any such proceedings are largely governed by that Act and by Part 66 of the Civil Procedure Rules 1998.

   Prior to the Crown Proceedings Act 1947 coming into force, the Crown was recognised as being liable for a debt or for a breach of contract, but claims could only be enforced by a petition of right which needed the consent of the Crown. Section 1 of the Act abolished this requirement. In other words, the normal rules governing contractual liability apply to the Crown, conferring jurisdiction on the English courts in relation to civil proceedings against the Crown. These rules will therefore apply to an ISDA Master Agreement between a party and the Crown acting through the Treasury.

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[78] The position in relation to a foreign Sovereign would be somewhat different. Foreign Sovereign Counterparties do not fall within the scope of this supplemental opinion.

Operating the close-out netting provisions of the ISDA Master Agreement in order to determine a net close-out amount under Section 6(e) of the ISDA Master Agreement in relation to the Crown following an Event of Default in relation to the Crown would not require the involvement of a court. However, we have already confirmed that if an English court were asked to consider the enforceability of this determination against the Crown acting through the Treasury, the English court would find that the determination was enforceable, subject to the assumptions and qualifications referred to in part 4 of this supplemental opinion.

(f) Immunity from execution

In the case of a close-out amount payable by the Crown, a further question would arise as to whether a judgment against the Crown given by an English court could be enforced against assets of the Crown in the United Kingdom. Under the Crown Proceedings Act 1947, no process of enforcement, including injunctive relief and specific performance,[79] can be invoked against the Crown. The waiver of immunity set out in Section 13(d) of the ISDA Master Agreement would therefore not have any effect for the purpose of enforcement. As the duty to comply with a court order is imposed by statute, it has been suggested that, in the unlikely event that the Crown did not honour the order, a mandatory order might be issued to compel the Chancellor of the Exchequer, as the relevant minister, to comply with his duty to pay the damages.[80]

2. *Political risk*

Inevitably when dealing with a Sovereign, including the Crown acting through the Treasury, a party will want to consider political risk. This is a large and complex topic, with a number of dimensions, of which the legal dimension is only one. Strictly speaking, political risk does not affect the principles outlined above.

It is, however, of course, possible that the Crown might repudiate its obligations under the ISDA Master Agreement in whole or in part. It could not do so lawfully under the current state of the law, but taking effective enforcement action against the Crown in those circumstances could be more difficult for political reasons than in relation to a private sector Counterparty.

Similarly, the Crown could purport to transfer its rights and/or novate its obligations under individual Transactions to other entities, most likely owned or controlled by the UK government, with the effect of disrupting the mutuality of obligations under the ISDA Master Agreement between a party and the Crown, leaving the party with an enhanced credit exposure to the Crown while owing money to another entity, with a consequent loss of the risk-reducing benefit of close-out netting.

We are not aware of any specific legislation currently in effect under which the Crown could take any of the above actions lawfully, but the risk always exists that the Crown could implement emergency legislation giving itself such powers. The Crown conferred significant property transfer powers (among other powers) on the Treasury in relation to English banks under the Banking (Special Provisions) Act 2008, passed on an emergency basis in the aftermath of the collapse of Northern Rock. Similarly, the Crown could pass legislation retrospectively invalidating the ISDA Master Agreement in whole or in part, including the close-out netting provisions of the ISDA Master Agreement.

These risks exist whenever a party is dealing with a Sovereign, and a party might prudently conclude that, in relation to the United Kingdom, the risk of the Crown taking any such action in relation to an existing agreement, in preference to honouring its obligations under such agreement in full, is

79 Section 21(1) of the CPA.
80 See W Wade and CF Forsyth, *Administrative Law* (10th edn, OUP 2009) 521.

remote, given the disastrous effect that any such action would have on its ability to access the financial markets or more generally on its reputation as a stable political democracy and leading industrialised nation. Furthermore, in the case of any legislative action that could be characterised as expropriating a party, the party could have redress against the United Kingdom under the European Convention on Human Rights.

Finally, instead of an act selectively affecting the ISDA Master Agreement between a party and the Crown (or a broader class of agreements of which the ISDA Master Agreement between that party and the Crown forms part), the Crown could declare a moratorium on repayment of its debt, impose exchange controls or take another general action that might affect its performance of its obligations under the ISDA Master Agreement. The legality of any such action would need to be considered in light of the specific action taken and the legislative basis for such action invoked in the particular case, but again these are risks of a political nature that may arise when dealing with a Sovereign or, indeed, with any counterparty within a particular jurisdiction where a Sovereign may take such actions. Accordingly, while these risks may be borne in mind, it seems reasonable to assume that they are remote in relation to the United Kingdom.