

INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, INC.

FCM

**Enforceability upon a Customer's Insolvency or Other Default of the Position
Liquidation, Margin Liquidation and Determination of Account Provisions of a
Customer Agreement pursuant to which a US Futures Commission Merchant
Clears Futures and/or Cleared Swaps for the Customer**

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British Virgin Islands

HARNEYS

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Dear Sirs

Enforceability upon a Customer's Insolvency or Other Default of the Position Liquidation, Margin Liquidation and Determination of Account Provisions of a Customer Agreement pursuant to which a US Futures Commission Merchant Clears Futures and/or Cleared Swaps for the Customer

British Virgin Islands

1 Introduction

- 1.1 We have been asked to advise the International Swaps and Derivatives Association, Inc. (**ISDA**) and the Futures Industry Association (**FIA**) regarding the enforceability under the laws of the British Virgin Islands of the Position Liquidation, Margin Liquidation and Determination of Account provisions (collectively, **remedial provisions**) of a customer agreement (the **Covered Agreement**) pursuant to which a futures commission merchant (the **FCM**) registered with the Commodity Futures Trading Commission (the **CFTC**) clears Futures and/or Cleared Swaps for a customer located in the British Virgin Islands (the **Covered Customer**).
- 1.2 A Covered Agreement generally consists of (i) a customer account agreement (a **Base Account Agreement**) if the Covered Customer trades only Futures, and (ii) a Base Account Agreement and a Cleared Derivatives Addendum substantially in the form published by FIA and ISDA in 2012 or 2018 (either, the **CDA**) if the Covered Customer trades only Cleared Swaps or trades both Futures and Cleared Swaps.
- 1.3 The types of transactions that may be cleared for the Covered Customer pursuant to the Covered Agreement include US Futures, Foreign Futures and Cleared Swaps (together, **Covered Transactions** or **Covered Contracts**).
- 1.4 We have been provided with a memorandum dated 17 November 2021 from Sullivan & Cromwell LLP "Regarding Futures and Options Transactions, Cleared Swaps and Foreign Futures Transaction Executed and Carried by Futures Commission Merchants for their Customers" (the **Sullivan &**

Cromwell memorandum). We have also been provided with a high-level overview and summary of the main concepts covered, conclusions reached and certain factual assumptions in the Sullivan & Cromwell memorandum (the **Summary Annex**) which we have included at Annex 1.

- 1.5 This opinion is given with respect to Covered Customers organised in the British Virgin Islands as any of the customer types described in Appendix A.
- 1.6 This opinion is subject to the details, definitions, assumptions and fact patterns set out in the instructions from ISDA (the **Instructions**) set out in full in Annex 2. Additional assumptions are contained in Schedule 1. Schedules 2, 3, 4 and 5 set out certain matters of British Virgin Islands law referred to in the body of the opinion.
- 1.7 Terms defined in the Summary Annex or the Instructions have the same meanings in this opinion unless otherwise defined.
- 1.8 This opinion is confined to matters of British Virgin Islands law and nothing herein should be construed to express or imply any opinion with regard to any other system of law. While it is a separate legal jurisdiction the British Virgin Islands follows general principles of English common law. The opinion is limited in scope to the matters expressly commented on.
- 1.9 This opinion is addressed to the International Swaps and Derivatives Association, Inc. (**ISDA**) and the Futures Industry Association (**FIA**) solely for the benefit of their members in relation to their use of Covered Agreements. No other person may rely on this opinion for any purpose without our prior written consent. This opinion may, however, be shown by ISDA or FIA or an ISDA or FIA member to their advisors, members' advisors or auditors or any competent regulatory or supervisory authority for such members for the purposes of information only, on the basis that we assume no responsibility to such authority or any other person as a result or otherwise.

2 Opinions

PART I Position Liquidation, Margin Liquidation and Determination of Account

1. *Would the parties' agreement on governing law and submission to jurisdiction set out in each of the Base Account Agreement and CDA be given effect by a court in your jurisdiction, and what would be the consequences if they were not?*

- 2.1 The parties' agreement as to governing law in each of the Base Account Agreement and CDA would be upheld as a valid choice of law by the courts of the British Virgin Islands and applied by the courts in proceedings in relation to the Base Account Agreement and CDA as the proper law of those agreements.
- 2.2 The submission to jurisdiction would be upheld assuming it was made in good faith. However if a dispute in relation to the Base Account Agreement or CDA is related to the insolvency of a customer organised in the British Virgin Islands, it is possible that the British Virgin Islands courts would accept jurisdiction notwithstanding the provisions for jurisdiction. The conclusions of this opinion speak to the likely approach taken by a British Virgin Islands court in this situation.

2. *Would the Position Liquidation provisions of each of the Base Account Agreement and the CDA be enforceable under the laws of your jurisdiction and each of the Position Liquidation methods described in Section XI of the S&C Memo and paragraph 2.4 of the Summary Annex be recognized and upheld by a court in your jurisdiction? If a particular method would either not be upheld or may be challenged, please provide further detail and explain the reason for this.*

- 2.3 On the basis of the following, the Position Liquidation provisions of each of the Base Account Agreement and the CDA will be enforceable under the laws of the British Virgin Islands and each of

the Position Liquidation methods described in Section XI of the S&C Memo and paragraph 2.4 of the Summary Annex would be upheld in the British Virgin Islands.

2.4 Position Liquidation under the Base Account Agreement includes the FCM closing out or otherwise liquidating the Customer's open positions in its Contracts, and hedging risk incurred by the FCM in connection with an Event of Default, by any reasonable method, including by means of entering into offsetting transactions, risk-reducing transactions or hedging transactions, and by valuing any transactions entered into by the FCM. The CDA prescribes comparable Position Liquidation methods. In the case of either type of agreement, each of the methods seeks to "remove" or "close out" the position from the relevant omnibus customer positions account (whether at a DCO or foreign clearing organisation).

2.5 Our response to question 5 identifies some general risks to close-out, but these are potential challenges to transactions themselves rather than to the methodology of Position Liquidation. Otherwise British Virgin Islands law does not introduce grounds for challenging Position Liquidation as carried out by the FCM as principal under the Covered Agreement using any of the methods above, assuming they have been provided for in the Covered Agreement and are carried out on a basis recognised and commonly used in the derivatives markets.

3. *Would the FCM's holding of the Covered Contracts as an "agent-trustee" be recognized by a court in your jurisdiction as creating a valid trust over the Covered Contracts or would the court otherwise recognize the FCM's legal title to, and the Covered Customer's beneficial interest in, the Covered Contracts?*

(a) *If so, would the court characterize Position Liquidation as the FCM's exercising its contractual rights as principal vis-à-vis the DCO under the relevant DCO rules (or vis-à-vis the Foreign Futures Broker under the clearing agreement between the FCM and Foreign Futures Broker) and not as the FCM's acting as the Covered Customer's agent or as the FCM's enforcing its security interest in the Covered Contracts?*

(b) *Could the FCM's holding of the Covered Customer's Contracts be characterized as some alternative arrangement, such as a commission agency or as a collateral security arrangement? If so, how would the FCM's Position Liquidation be characterized under the laws of your jurisdiction?*

2.6 British Virgin Islands law recognises the concept of trusts and the British Virgin Islands courts would generally recognise a trust constituted by the laws of another jurisdiction on the terms of that constitution. Assuming clarity at any time on the Customer's rights to trust assets, we have no reason to believe the British Virgin Islands courts would not uphold such a trust and the courts would therefore recognise the Covered Customer's beneficial interest in the Covered Contracts. Furthermore the British Virgin Islands courts would generally uphold the right for the FCM as trustee to be reimbursed out of trust property for costs and expenses properly incurred.

2.7 As regards the characterisation of Position Liquidation, we do not believe the British Virgin Islands courts would feel compelled to consider the FCM's status vis-à-vis the DCO. From the British Virgin Islands perspective Position Liquidation involves the FCM acting as principal in exercising contractually agreed rights under the Customer Agreement, and not as agent or pursuant to a power of attorney of the Customer and this is not inconsistent with British Virgin Islands insolvency law.

4. *Would a court in your jurisdiction recognize the statutory trust with respect to the Segregated Funds or Separate Account Funds of each Account Class as creating a valid trust over such Segregated Funds or Separate Account Funds, and that under the terms of that trust, the FCM holds the legal title to, and the Covered Customer holds a beneficial interest in, the statutory trust as a whole (as opposed to maintaining an interest in any specific assets under the trust)? Could the statutory trust with respect to the Segregated Funds or Separate Account Funds of any Account Class be characterized as some alternative arrangement (e.g., as a collateral security arrangement)?*

(a) *Would the Margin Liquidation provisions of each of the Base Account Agreement and CDA be enforceable under the laws of your jurisdiction and the FCM's Margin Liquidation in respect of each Account Class be recognized and upheld by a court in your jurisdiction? Could such Margin Liquidation be capable of exercise based on the FCM's exercise of its right under the applicable Customer Property Rules to withdraw and apply Segregated Funds or Separate Account Funds, as the case may be, for Permitted Uses (the FCM's "Permitted Uses Rights") rather than by the enforcement of its security interest in the Covered Customer's Collateral consisting of securities?*

(b) *Would the Determination of Account provisions of each of the Based Account Agreement and CDA be enforceable under the laws of your jurisdiction and the FCM's Determination of Account in respect of (i) each Account Class and (ii) all Account Classes on a combined basis be recognized and upheld by a court in your jurisdiction and if so, how could each Determination of Account be characterized (e.g., contractual accounting, netting or set-off, enforcement of the security interest in cash Collateral or some combination of the foregoing)?*

2.8 The British Virgin Islands courts would generally recognise a statutory trust constituted by the laws of another jurisdiction on the terms of that constitution.

2.9 The British Virgin Islands courts would be reluctant to characterise a trust as a security interest if they would not be characterised as such under the laws governing their constitution or if the effect under those governing laws would not have the character of a security interest under British Virgin Islands law. In this case, the characteristics of the trust are consistent with the British Virgin Islands concept of a trust. As with English law, the British Virgin Islands concept of a trust shares certain characteristics with that of a security interest: however, our view is that even were the trust to be governed by British Virgin Islands law, its characteristics are not such that a British Virgin Islands court would characterise it as a security interest.

(a) *Margin Liquidation.* Our response to question 2 applies equally to Margin Liquidation. We believe the British Virgin Islands courts would uphold Margin Liquidation as carried out by the FCM as principal under the Covered Agreement, assuming it is done in accordance with the Covered Agreement and on a commercially reasonable basis.

While we do not believe it necessary to rely on Permitted Uses Rights to achieve Margin Liquidation, our view is that the British Virgin Islands courts would treat the validity of rehypothecation rights and other rights of use as governed by New York law¹ and would therefore uphold the right under the applicable Customer Property Rules to withdraw and apply Segregated Funds or Separate Account Funds. The FCM's use of Collateral is therefore a matter of contract between the parties.

(b) *Determination of Account.* For the reasons which follow and subject to our comments in respect of certain entity types, we believe the Determination of Account provisions of each of the Base Account Agreement and CDA would be enforceable under the laws of the British Virgin Islands and the FCM's Determination of Account in respect of (i) each Account Class and (ii) all Account Classes on a combined basis would be recognised and upheld by a court in the British Virgin Islands. We summarise the analysis using contractual accounting, close-out netting, insolvency set-off and security enforcement below. While the insolvency

¹ If the Covered Agreement were governed by the laws of the British Virgin Islands there may be arguments as to the FCM's right to use the Collateral as it may be seen as constituting a "clog on the equity of redemption" or otherwise being an "unlawful collateral advantage". There is no British Virgin Islands case law of which we are aware which is determinative of the issue of whether a provision which is valid under its governing law might still be struck down by the British Virgin Islands courts as a clog on the equity of redemption. In principal, a document which is valid under its governing law should be upheld and enforced in the British Virgin Islands unless it is contrary to public policy. In any case our view is that a security interest created over a fungible and shifting pool of collateral creates an entitlement of the collateral provider to receive back identical securities rather than the same securities, in which case a right of rehypothecation could not properly be construed as a clog even under British Virgin Islands law.

set-off analysis would not distinguish as separate calculations Determination of Account of each Account Class and Determination of Account of all Account classes on a combined basis, since the effect would be the same as that reached using other methods (and since Part XVII is expressed to prevail over insolvency set-off), we believe the British Virgin Islands courts would not interfere with Determination of Account on a contractual basis.

- (i) *Contractual accounting.* The failure to perform under an agreement gives rise to a claim for damages in accordance with general principles of contract law. Parties are free (with certain exceptions) to use a prearranged method of arriving at the amounts payable on termination of a contract. Calculation of damages by reference to a commercially acceptable and reasonable methodology would be acceptable under British Virgin Islands law. Noting our comments below and in our response to question 5 and our comments on the enforceability of Position Liquidation and Margin Liquidation, we believe the courts would uphold Determination of Account based on contractual accounting, notwithstanding close-out as a result of insolvency proceedings in respect of the Customer.
- (ii) *Netting agreements.* Part XVII (*Netting and Financial Contracts*) of the Insolvency Act (**Part XVII**) (see Schedule 4) provides that notwithstanding anything contained in the Insolvency Act, any rules promulgated under the Insolvency Act or in any rule of law relating to insolvency, provisions relating to the netting of obligations under a netting agreement shall be enforceable against each party to that contract. In our view, a Covered Agreement will constitute a “netting agreement” under Part XVII for US Futures, Foreign Futures and Cleared Swaps. Section 150 of the Insolvency Act, relating to insolvency set-off, is expressly made subject to Part XVII, and so if the insolvency set-off rules under British Virgin Islands law were to produce a different result from the Determination of Account provisions, the Determination of Account provisions would prevail.
- (iii) *Insolvency set-off.* If Part XVII does not apply, either because the Covered Agreement would not constitute a netting agreement for the purposes of Part XVII or for reasons of fraud or misrepresentation, insolvency set-off would apply to any amounts arising from dealings prior to the commencement of liquidation² and prior to the FCM having knowledge of the insolvency of the Customer. Section 150(4) of the Insolvency Act provides that a party may before the commencement of liquidation waive the benefit of set-off, and the effect of insolvency set-off is therefore likely to have a similar effect to contractual netting provisions. Where Part XVII does not apply however, transactions may be subject to avoidance as a preference or undervalue transaction (see Schedule 3 and our response to question 5).
- (iv) *Security enforcement.* The security provisions are covered in Part II of this opinion and, subject to caveats below, will be enforceable through insolvency proceedings. Where there is any question about the legal analysis of Determination of Account on a netting basis, the enforceability of security provisions provides additional reassurance that the effect of the Determination of Account provisions will be upheld.

Segregated portfolio companies. Part XVII defines a netting agreement as an agreement “between two parties”, “party” being “a person constituting one of the parties to an

² “Commencement of liquidation” is not defined in the Insolvency Act, though section 175, in providing that “with effect from the commencement of the liquidation... the liquidator has custody and control of the assets of the company”, implies that the commencement of liquidation is the appointment of a liquidator. This is distinct from “onset of liquidation” which is statutorily defined in relation to voidable transactions.

agreement". There has not yet been any judicial consideration of how far "person" should extend. Nevertheless we believe that a portfolio of a segregated portfolio company should be treated as a person for these purposes. Although the portfolio itself does not have separate legal personality, it only engages in transactions through the segregated portfolio company itself (which clearly does have separate legal personality). Although the strictures relating to the treatment of portfolio assets and portfolio liabilities would prevent recognition or enforcement of any netting of assets and liabilities outside the specific portfolio in question, we believe that Part XVII should be effective to ensure primacy be given to the Determination of Account provisions in the event of any Insolvency Proceedings³ and the conclusions in relation to British Virgin Islands companies above should therefore apply equally to segregated portfolios of SPCs. There is no requirement of British Virgin Islands law that an agreement with an SPC must include contractual terms reflecting the statutory provisions preventing the attribution of liabilities of one portfolio to the assets of a separate portfolio either prior to or after the onset of insolvency. However it is important that the Covered Agreement clearly identifies for the account of which segregated portfolio the SPC is entering into the Covered Agreement.

Partnerships. Subject to our comments below, the conclusions of this opinion in respect of Companies apply to partnerships, and Determination of Account provisions will be enforceable against all forms of partnership. In particular the applicability of Part XVII is not limited to Companies and we believe any form of partnership will still constitute one "party" for the purposes of Part XVII.

- (i) *General Partnerships.* Partners of General Partnerships are only liable for the partnership debts which accrue during the time when they are a partner. Mutuality concerns therefore arise where there is a change of a partner. A General Partnership would ordinarily be dissolved on the insolvency of a partner. Otherwise there is no statutory provision for the liquidation of General Partnerships. Although, in the absence of insolvency law, a British Virgin Islands court would not interfere with the operation of netting provisions there is some question as to how the courts would deal with Transactions entered into by different partners. We therefore make the following recommendations.
 - (1) Parties wishing to enter into Covered Agreements with General Partnerships should (i) always do so with the same partner and (ii) prohibit any change of partner unless all Transactions have been formally novated to a new partner.
 - (2) Given the likely effect of partner insolvency on the existence of the partnership, consider terminating on the bankruptcy or insolvency of any partner. In any case the bankruptcy or insolvency of the partner with which Transactions are entered into on behalf of the partnership should be treated as a termination event.
 - (3) As a practical measure the identity of the contracting partner should be included in the description of the Customer in all documentation.
- (v) *1996 Limited Partnerships.* General partners of 1996 Limited Partnerships are only liable for the partnership debts which accrue during the time when they are a general partner. Mutuality concerns therefore arise where there is a change of a general partner. A 1996 Limited Partnership would ordinarily be dissolved on the

³ Consideration should be given as to whether Insolvency Proceedings in respect of the segregated portfolio company itself as well as the specific portfolio are included as close-out triggers.

insolvency of a partner. Otherwise there is no statutory provision for the liquidation of 1996 Limited Partnerships. Although, in the absence of insolvency law, a British Virgin Islands court would not interfere with the operation of netting provisions there is some question as to how the courts would deal with Transactions entered into by different general partners. We therefore make the following recommendations.

- (1) Parties wishing to enter into Covered Agreements with 1996 Limited Partnerships should (i) always do so with the same general partner and (ii) prohibit any change of general partner unless all Transactions have been formally novated to a new general partner.
 - (2) Given the likely effect of partner insolvency on the existence of the partnership, consider terminating on the bankruptcy or insolvency of any partner. In any case the bankruptcy or insolvency of the general partner with which Transactions are entered into on behalf of the partnership should be treated as a termination event.
 - (3) As a practical measure the identity of the contracting general partner should be included in the description of the Customer in all documentation.
- (vi) *2017 Limited Partnerships without Legal Personality.* A 2017 Limited Partnership without Legal Personality will terminate after 90 days (or such period is as is specified in the partnership agreement or by the court) without at least one solvent general partner and at least one solvent limited partner. There is some friction between the lack of legal personality and the prescribed insolvency proceedings for 2017 Limited Partnerships without Legal Personality. Until this has been resolved we recommend treating them in the same way as 1996 Limited Partnerships including requiring novation of transactions on any change of general partner.
- (vii) *Limited Partnerships with Legal Personality.* A Limited Partnership with Legal Personality will terminate after 90 days (or such period is as is specified in the partnership agreement or by the court) without at least one solvent general partner and at least one solvent limited partner. Given legal personality of the partnership and codified insolvency proceedings, mutuality concerns are assuaged and Limited Partnerships with Legal Personality may be treated in the same way as Companies.

Trusts and unit trusts. For the reasons which follow and subject to our comments on mutuality on a change of trustee we are of the view that the Determination of Account provisions will be enforceable against trustees in respect of trust funds.

- (i) *Pre-insolvency.* On the assumption that the Transactions are within the powers of the trustees and permitted by the terms of the trust and are properly entered into, and the other party to the Agreement is not aware after due enquiry of any breach by the trustees, we are of the view that the Determination of Account provisions would be enforceable under British Virgin Islands law in accordance with their terms in the absence of a single trustee insolvency, the insolvency of all trustees or trust fund insolvency.
- (ii) *Single trustee insolvency.* For the purposes of this opinion, a **trustee insolvency** means the trustee's winding-up, administration, administrative receivership or bankruptcy. Where a single trustee becomes insolvent but there are other solvent trustees who are jointly or jointly and severally liable for the obligations under the Agreement, the third party would be entitled to proceed against any of the remaining solvent trustees who would have recourse to the assets of the trust to

meet that liability, or if applicable, the third party would have direct recourse to the trust assets pursuant to section 97 of the Trustee Act. Accordingly, a single trustee insolvency would not affect the enforceability of the netting provisions. Where the Agreement is silent on whether the trustees are jointly and severally liable there is a presumption that the trustees who execute such agreement will be jointly liable for the obligations under it. However specific language is required in the Agreement if the trustees are to be jointly and severally liable, which would improve the third party's position in the event of a single trustee becoming insolvent, because the third party's claim against a jointly liable trustee could be potentially lost whereas it would not be lost against jointly and severally liable trustees.

- (iii) *Insolvency of all trustees.* In practice the insolvency of multiple individual trustees would be a rare occurrence. Where there is a sole corporate trustee which becomes insolvent, the trust instrument would normally provide for the appointment of a new trustee. Following such substitution, the third 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. Such right of indemnity would of course, be limited to the extent of the original trustee's right of indemnity and the third party will be in a better position in relation to a trust created after 1 March 2004 where the indemnity contained in section 100 of the Trustee Act will apply. Note however our concerns in paragraph (v) below as to issues with mutuality following a change of trustee.
- (iv) *Trust fund insolvency.* If the trust fund itself (rather than its trustees) were to become insolvent the trust will not be wound up under the British Virgin Islands insolvency legislation as it is not a separate legal entity. On a trust fund insolvency a creditor or other party claiming a beneficial interest under the trust may however apply to the British Virgin Islands court under Part 67 of the Civil Procedure Rules for "an Order for the execution of a Trust to be carried out under the direction of the Court", referred to as an administration order (but not to be confused with an administration order under Part III of the Insolvency Act). The administration procedure is entirely discretionary and the trust fund's assets will be administered by the court as its discretion may direct in accordance with principles of justice and equitability. It is important to note that Part 67 of the Civil Procedure Rules contains no mandatory set-off rules, and that section 150 of the Insolvency Act dealing with insolvency set-off is only applicable in the liquidation of companies and the bankruptcy of individuals and does not apply to trusts. However, as discussed above in respect of partnerships the provisions of Part XVII are not so limited.
- (v) *Mutuality and changes of trustees.* For similar reasons to those given for General Partnerships above we have reservations as to whether mutuality will be preserved across a change of trustee and therefore recommend that parties wishing to enter into Covered Agreements with trusts should prohibit changes of trustees.

5. *Are there any other circumstances in your jurisdiction, including any moratorium, stay, freeze or other consequence of the commencement of an insolvency proceeding, you can foresee that might affect the FCM's ability to exercise Position Liquidation, Margin Liquidation or a Determination of Account in respect of an Account Class or the overall Customer Account (comprising the three Account Classes)?*

2.10 There are no grounds under British Virgin Islands law for imposing a moratorium, stay or freeze on the exercise of Position Liquidation, Margin Liquidation or a Determination of Account in respect of

an Account Class or the overall Customer Account on the commencement of an insolvency proceeding.

2.11 We have set out below other potential risks to the exercise of Position Liquidation, Margin Liquidation or a Determination of Account provisions under British Virgin Islands insolvency laws. We do not believe these are material in the context of a Covered Agreement.

(a) *Avoidance risk.* Avoidance risks are summarised in Schedule 3 **Schedule 5** and apply to Customers which are British Virgin Islands companies (**BVIBCs**) only. Assuming the Covered Agreement is entered into for bona fide commercial reasons and at arms' length by each of the parties and with no intent to defraud creditors it is unlikely these would pose material risk to the exercise of Position Liquidation, Margin Liquidation or a Determination of Account.

(b) *Disclaimer of onerous contracts.* The effect of disclaiming a contract is to create a claim for loss or damage against the estate of the insolvent party. In effect it would result in the same valuation process. A liquidator cannot disclaim a single transaction.

2.12 The analysis is simplified where Part XVII applies. Part XVII is summarised in Schedule 4 and is likely to apply to all Covered Transactions, in which case any risks associated with Insolvency Proceedings discussed in the previous paragraphs may be disregarded and the risk of a successful challenge to Position Liquidation, Margin Liquidation or a Determination of Account is low.

6. *Under the laws of your jurisdiction, are any rights or processes available to a creditor of a Covered Customer by which such creditor could make a claim against the Segregated Funds or Separate Account Funds held subject to the statutory trust (or otherwise in accordance with the Customer Property Rules) in respect of each Account Class or against the Covered Contracts (and any rights in respect thereof) held by the FCM as agent-trustee for the benefit of the Covered Customer and the FCM's other customers in such Account Class as opposed to only having recourse to the final cash balance or single net termination amount that constitutes the Determination of Account for such Account Class or the overall Customer Account (comprising the three Account Classes)?*

2.13 For a creditor of a Covered Customer to have a claim against the Segregated Funds or Separate Account Funds held subject to the statutory trust, that creditor would have to have a proprietary right to the Segregated Funds or Separate Account Funds.

2.14 On the assumption that as a matter of New York law a beneficiary's interest in respect of the statutory trust is in the trust property as a whole and not in any specific asset, this will be recognised under British Virgin Islands law. British Virgin Islands law would therefore not treat the Covered Customer as having a proprietary right to any specific item of the trust property and by extension a creditor of a Covered Customer will not have a proprietary right to any specific item and will not be entitled to claim against any particular asset.

7. *Assuming the parties have entered into the Covered Agreement, the Covered Customer is insolvent and the FCM has determined a lump-sum cash balance or net termination amount in a currency other than the currency of the jurisdiction in which the insolvent customer is organized:*

(a) *Would a court in your jurisdiction enforce a claim for the cash balance or net termination amount in the currency in which it was determined?*

(b) *Can a claim for the cash balance or net termination amount be proved in insolvency proceedings in your jurisdiction without conversion into the local currency?*

If in either case the claim must be converted to local currency for purposes of enforcement or proof in insolvency proceedings, please set out the rules governing the timing and exchange rate for such conversion.

2.15 Since the British Virgin Islands courts have power to grant a monetary judgment expressed otherwise than in the currency of the British Virgin Islands, any monetary judgment⁴ of a court in the British Virgin Islands in respect of a claim for the net termination amount is likely to be expressed in the currency in which such net termination amount is determined, assuming that is the currency in which such claim is made.

2.16 Any claim in the liquidation of a BVIBC or a 2017 Limited Partnership⁵ based on a liability incurred or payable in a currency other than US dollars must be converted into US dollars.

8. *Are there any other local law considerations that you would recommend the FCM to consider in connection with the exercise of Position Liquidation, Margin Liquidation or a Determination of Account?*

2.17 No.

PART II Creation, Perfection and Enforcement of FCM's Security Interest in Covered Collateral

Creation and perfection of the security interest

1. *Under the laws of your jurisdiction, what law governs the contractual aspects of the security interest in the various forms of Covered Collateral?*

2.18 Contractual aspects of the security interest in the various forms of Covered Collateral, including the creation and validity of the security interest, would be governed by the chosen law of the Covered Agreement.

2. *Under the laws of your jurisdiction, what law governs the proprietary aspects of the security interest in the different types of Covered Collateral (that is, the formalities required to protect the security interest against competing claims) granted by the Covered Customer (for example, the law of the jurisdiction of incorporation or organization of the Covered Customer, the jurisdiction where the Covered Collateral is Located or the jurisdiction of location of the FCM as the Covered Customer's Intermediary, in relation to Covered Collateral in the form of indirectly held securities)? What factors would be relevant to this question? If the Location (or deemed Location) of the Covered Collateral is the determining factor, please briefly describe the principles governing such determination under the law of your jurisdiction with respect to the different types of Covered Collateral. If relevant, please describe how the laws of your jurisdiction apply to each form in which securities Covered Collateral may be held as described in assumption (b) above.*

⁴ Any final and conclusive monetary judgment for a definite sum obtained in the English High Court may be registered and enforced as a judgment of the British Virgin Islands court under the Reciprocal Enforcement of Judgments Act (Cap 65) (the **REJA**) provided that (i) application for registration of the judgment is made within twelve months of its date (or such longer period as the British Virgin Islands court may allow), (ii) the relevant party is not appealing and does not have the right and intention to appeal and (iii) the British Virgin Islands court considers it just and convenient that the judgment be so enforced. Judgments of the English County Courts and the New York courts (and the courts of most other jurisdictions) may not be registered under the REJA. However, a judgment obtained in the English County Courts or the New York courts may be treated as a cause of action in itself and sued upon as a debt at common law so no retrial of the issues would be necessary. In this case an appeal is irrelevant unless a stay of execution has been granted. An English High Court judgment may also be enforced in this way, but the applicant may be penalised on costs. Whether registering a judgment under the REJA or suing upon a judgment as a debt at common law, it will be necessary that (i) the relevant court had jurisdiction in the matter and the parties either submitted to such jurisdiction or was resident or carrying on business within such jurisdiction and was duly served with process, (ii) the judgment was not in respect of penalties, fines, taxes or similar fiscal or revenue obligations, (iii) in obtaining judgment there was no fraud on the part of the person in whose favour judgment was given or on the part of the court, (iv) recognition or enforcement in the British Virgin Islands would not be contrary to public policy and (v) the proceedings pursuant to which judgment was obtained were not contrary to the principles of natural justice.

⁵ Since there are no statutory insolvency proceedings for trusts or partnerships other than 2017 Limited Partnerships, there is no equivalent provision for claims in their liquidation.

2.19 Under British Virgin Islands rules, the law governing proprietary aspects of the security interest in the different types of Covered Collateral will be that of the jurisdiction where the Covered Collateral is located at the time the security interest attaches to the Covered Collateral.

- (a) Cash will be located in the place where the relevant account is maintained⁶. This is likely to be the location of Covered Customer's account on the books of the FCM.
- (b) British Virgin Islands law would ordinarily consider the location of a directly held, registered certificated security to be the place where the register is located. A directly held physically certificated bearer security will be located in the place where the relevant certificate is located. However in certain circumstances the *situs* of an equity security such as shares or warrants may be the place where the issuing company is incorporated (either generally, or for specific purposes such as validity of transfers). In particular, for the purposes of determining matters relating to title and jurisdiction, the location of the ownership of shares, debt obligations or other securities of a BVIBC is the British Virgin Islands⁷.
- (c) In relation to securities held indirectly or on a fungible basis with or through a custodian or securities depository, including in a securities account, a British Virgin Islands court is likely to adopt the "place of the relevant intermediary approach" (*PRIMA*)⁸.
- (d) Debts are usually deemed to be located at the place where the debtor (in this case an FCM which holds cash belonging to the customer) ordinarily resides. The main exceptions are debts arising under a letter of credit (which are normally located at the place of presentation) and debts arising from a specialty contract (which existing case law suggests are located in the place of the speciality instrument, although some commentators suggest that older case law might not be followed by the courts today).
- (e) Contract rights are generally located where those rights would be enforced. In the case of contract rights a British Virgin Islands court would, subject to certain restrictions such as public policy issues and any attempt to contract out of statutory provisions regarding title and location of shares debts and securities, look to the governing law of the underlying contract for issues of perfection.

2.20 In practice, the British Virgin Islands is unlikely to be a relevant location for proprietary reasons either because Covered Collateral is not located in the British Virgin Islands or because there will be no perfection requirements in the British Virgin Islands. Note however our comments on registration of security in our response to question 5 below.

3. *Would the courts of your jurisdiction recognize the validity of a security interest in the different types of Covered Collateral, assuming it is valid under New York law? In answering this question, please bear in mind the different forms in which securities Covered Collateral may be held, as described in the assumptions above. Please indicate, in relation to cash Covered Collateral, if your answer depends on the*

⁶ *Arab Bank v Barclays Bank (Dominion, Colonial and Overseas)* 1954 AC 495

⁷ Section 245 of the BVIBC Act. There is some friction between this provision and (i) our views on the application of PRIMA and (ii) our comments in the first sentence of paragraph (b) where the register is held outside the British Virgin Islands. Where the register is held outside the British Virgin Islands, the British Virgin Islands courts would be bound by the statutory provision and, while it would clearly be advisable to take any perfection steps required in the jurisdiction where the register is held, the courts would usually determine whether title had been transferred under British Virgin Islands law. Bearer shares have effectively been abolished in the British Virgin Islands so will not be relevant for this analysis. Where securities are held indirectly, our presumption is that the British Virgin Islands courts would only look as far as the depository in applying British Virgin Islands law to determine title. We believe the British Virgin Islands courts would consider the transfer of any indirect or fungible rights to those shares as equitable interests. British Virgin Islands law does not provide for the transfer of equitable rights so there would be no inconsistency in applying PRIMA to determine applicable law.

⁸ As set out in the Hague Convention of 5 July 2006 on the Law Applicable to Certain Rights in respect of Securities held with an Intermediary.

location of the account in which the relevant deposit obligations are recorded and/or upon the currency of those obligations.

- 2.21 The British Virgin Islands courts would recognise the validity of a security interest in the different types of Covered Collateral provided the security interest was valid under (a) the governing law of the Covered Agreement and (b) the *lex situs* of the Covered Collateral, provided always that any mandatory perfection requirements in relation to the Covered Collateral arising under the laws of any other jurisdiction had been complied with.
- 2.22 In relation to cash Covered Collateral, the location of the place of the account will normally determine the *lex situs*, and so will be relevant. However the currency of any cash Covered Collateral is not relevant under British Virgin Islands law for these purposes.
- 2.23 The laws of the British Virgin Islands do not impose any additional requirements of form or otherwise for the recognition or validity of a security interest (other than where the assets comprise shares in a BVIBC⁹).

4. *What is the effect, if any, under the laws of your jurisdiction of the fact that the amount secured or the amount of any cash or securities Covered Collateral subject to the security interest will fluctuate under the Covered Agreement (including as a result of entering into additional Covered Transactions from time to time)? In particular:*

(a) *Would the security interest be valid in relation to future obligations of the Covered Customer?*

(b) *Would the security interest be valid in relation to future Covered Collateral (that is, Covered Collateral not yet delivered to the FCM at the time of entry into the Covered Agreement)?*

(c) *Is there any difficulty with the concept of creating the security interest over a fluctuating pool of assets, for example, by reason of the impossibility of identifying in the Covered Agreement the specific assets deposited by the Covered Customer with the FCM?*

(d) *Is it necessary under the laws of your jurisdiction for the amount secured by the security interest to be a fixed amount or subject to a fixed maximum amount?*

(e) *Is it permissible under the laws of your jurisdiction for the FCM to hold Customer Collateral in excess of its actual exposure to the Covered Customer under the Covered Agreement?*

In relation to (a), it is understood that the security interest in any specific Covered Collateral would only be relevant in relation to future obligations, if ever, at the time such future obligations arise and then only in relation to Covered Collateral held at that time. This question concerns whether it would be necessary for either party to perform any action at such time in order to ensure the effectiveness of the security interest as security for such obligations or whether the security interest would take effect in relation to those future obligations without further action by either party.

In relation to (b), it is understood that the security interest in the different types of Covered Collateral to be delivered at some point in the future after the time of entry into the Covered Agreement would not take effect in relation to such Covered Collateral until it had been delivered to the FCM in accordance with the Covered Agreement. This question concerns whether it would be necessary for either party to perform any action at such time in order to ensure the effectiveness of the security interest in relation to such Covered

⁹ If the Covered Collateral comprises shares in a BVIBC, in order to create a valid mortgage or charge, the BVIBC Act requires that there must be a written instrument which clearly indicates (a) the intention to create a mortgage or charge and (b) the amount secured by the mortgage or charge or how that amount is to be calculated. Where the collateral comprises bearer shares in a BVIBC the share certificates must be deposited with a custodian which is either recognised or authorised by British Virgin Islands law.

Collateral or whether the security interest in relation to such Covered Collateral would take effect without further action (other than the delivery) by either party.

In relation to (c), you may assume that each specific delivery to the FCM and return by the FCM of Covered Collateral consisting of cash or securities under the Covered Agreement from time to time would be properly recorded by the FCM, so that, while the pool of Collateral would change from time to time, at any specific time the composition of the pool of Collateral could be clearly identified by the FCM.

2.24 There is no difficulty under the laws of the British Virgin Islands if the amount of any cash or securities Covered Collateral subject to the security interest will fluctuate under the Covered Agreement.

2.25 In answer to the specific questions on this point:

- (a) Yes, the security interest would be recognised as valid in relation to relation to future obligations of the Covered Customer provided that the future obligations can be determined with sufficient certainty as and when they arise by reference to the terms of the Covered Agreement.
- (a) Yes, the security interest would be valid in relation to future Covered Collateral provided the future Covered Collateral can be ascertained as and when it is provided. Under British Virgin Islands law it is possible to create security interests over future property, and the British Virgin Islands courts would give effect to such a power arising under any foreign legal system.
- (b) No, there is no difficulty with a security interest being created over a fluctuating pool of assets provided the fluctuating pool of assets over which the security interest to be created is identified with sufficient certainty in order to identify the collateral at any given time. Note that where assets may be substituted freely by the Covered Customer there is a risk that a British Virgin Islands court might characterise the security interest as floating.
- (c) No, it is not necessary under the laws of the British Virgin Islands for the amount secured by the security interest to be a fixed amount or subject to a fixed maximum amount.
- (d) Yes, it is permissible under the laws of the British Virgin Islands for the FCM to hold Customer Collateral in excess of its actual exposure to the Covered Customer under the Covered Agreement, provided it has been agreed by the parties that such excess may be held. In the event of any enforcement the FCM would normally need to account for any excess where the proceeds of enforcing the security exceeds the amount of the secured obligations.

5. *Assuming that the courts of your jurisdiction would recognize the security interest in each type of Covered Collateral, is any action (filing, registration, notification, stamping, notarization or any other action or the obtaining of any governmental, judicial, regulatory or other order, consent or approval) required in your jurisdiction to perfect the security interest? If so, please indicate what actions must be taken and how such actions may differ, if at all, depending upon the type of Covered Collateral which is subject to the security interest.*

2.26 No action is required under the laws of the British Virgin Islands to perfect the security interest. However under British Virgin Islands law a security interest created by a BVIBC or a 2017 Limited Partnership over Covered Collateral located in any jurisdiction should be registered in the British Virgin Islands in order to maintain priority in the event of an application to enforce before a British Virgin Islands court. Registration should be made on the Register of Registered Charges by submitting an application in the approved form to the British Virgin Islands Registry of Corporate Affairs (the **Registry**). A BVIBC or a 2017 Limited Partnership is also required to enter particulars of

the security interest on a register of charges and maintain a copy of the register at its registered office, although failure to do so does not affect the security interests but merely gives rise to penalties.

- 2.27 Failure to register at the Registry will not affect the validity of the security interest as against the BVIBC or the 2017 Limited Partnership or any liquidator on its insolvency but may result in a loss of priority as against subsequent registered secured creditors. An unregistered security interest will rank after registered secured interests but before any subsequent unregistered security interests, by an application of the rule that when the equities are equal the first in time shall prevail, and subject to the priority accorded to a fixed charge over a floating charge which does not contain a negative pledge, perfection by notice, contractual subordination or similar requirements.
- 2.28 Under the Registration and Records Act 1881 (the **Registration and Records Act**), every document which is executed as a deed must be registered at the Deeds Registry in the British Virgin Islands or it will be void against a subsequent purchaser for value or mortgagee. The definition of deed for these purposes “includes every document in writing affecting or relating to lands, tenements or hereditaments in the [British Virgin Islands]”. While it is widely assumed that this definition was intended to be construed in a restrictive fashion to matters relating to land within the British Virgin Islands, this has never been tested judicially and it remains possible that a court would apply the provisions to any document entered into as a deed by a limited partnership or trust or a company organised under foreign law which maintains a registered office in the British Virgin Islands. BVIBCs are specifically exempted from the Registration and Records Act. There is a time limit for registration of three months if the deed is executed within the British Virgin Islands and twelve months if executed outside the British Virgin Islands.
- 2.29 Otherwise there is no registration regime for security interests created by trusts or partnerships, other than 2017 Limited Partnerships and priority between competing security interests would, subject to our comments above, be determined by common law.
- 2.30 Where security has been created over shares in a BVIBC, the BVIBC may make a notation of the security interest in its share register. Although the notation has no statutory effect it will give notice to any party reviewing the share register of the security interest. It is also possible for the BVIBC to file a copy of its annotated share register with the Registry to make notice of the security interest publicly available.

6. *If there are any other requirements to ensure the validity or perfection of the security interest in each type of Covered Collateral, please indicate the nature of such requirements. Are there any other documentary formalities that must be observed in order for the security interest in any type of Covered Collateral to be recognized as valid and perfected in your jurisdiction?*

- 2.31 There are no documentary or any particular additional requirements or formalities to be carried out in order to ensure the validity or perfection of the security interest.

7. *Assuming that the FCM has obtained a valid and perfected security interest under the laws of your jurisdiction, to the extent such laws apply, by complying with the requirements set forth in your responses to questions C.1 to C.6 above, as applicable, will the FCM or the Covered Customer need to take any action thereafter to ensure that the security interest continues to be and/or remains perfected, particularly with respect to additional cash or securities Covered Collateral transferred from time to time when required pursuant to the Covered Agreement?*

- 2.32 No additional actions need to be taken by the FCM or the Covered Customer in the British Virgin Islands in order to ensure that the security interest continues to be and/or remains perfected.
- 2.33 Where it is not the British Virgin Islands the laws of the jurisdiction where the Covered Collateral is located may impose perfection requirements in respect of additional Covered Collateral.

8. *Are there any particular duties, obligations or limitations imposed on the FCM in relation to the care of the Covered Collateral held by it pursuant to the security interest?*

2.34 Under the laws of the British Virgin Islands the FCM is under an obligation established by case law to take reasonable steps to ensure the safe custody of any charged property in its possession.

9. *Do the laws of your jurisdiction recognize the right of the FCM to use cash or securities Covered Collateral (as described in additional assumption II.B.(f) above) pursuant to an agreement with the Covered Customer? In particular, how does such use of the Covered Collateral affect, if at all, the validity, continuity, perfection or priority of the security interest otherwise validly created and perfected prior to such use? Are there any other obligations, duties or limitations imposed on the FCM with respect to its use of such Covered Collateral under the laws of your jurisdiction?*

2.35 As the Covered Agreement is governed by New York law¹⁰, the validity of any right of the FCM to use cash or securities Covered Collateral will be governed by New York law, and we do not believe there is any reason in principle why a British Virgin Islands court would seek to interfere with such an arrangement if it is valid as a matter of New York law. The FCM's use of Covered Collateral is a matter of contract between the parties.

Enforcement of the security interest in Covered Collateral in the absence of an insolvency proceeding

Note the additional assumption in the Instructions which applies to questions 10 to 12 below.

10. *Assuming that the FCM has obtained a valid and perfected security interest under the laws of your jurisdiction, to the extent such laws apply, by complying with the requirements set forth in your responses to questions 1 to 6 above, as applicable, what are the formalities (including the necessity to obtain a court order or conduct an auction), notification requirements (to the Covered Customer or any other person) or other procedures, if any, that the FCM must observe or undertake in enforcing its security interest as an FCM under the Covered Agreement? For example, is it free to sell the Covered Collateral (including to itself) and apply the proceeds to satisfy the Covered Customer's outstanding obligations under the Covered Agreement? Do such formalities or procedures differ depending on the type of Covered Collateral involved?*

2.36 Subject to the following comments on exercise of a power of sale, it is not necessary for any particular formalities to be observed or undertaken by the FCM in exercising its security interest.

- (a) In exercising a power of sale, the FCM is subject to a duty to take reasonable care to obtain the best price reasonably available at the time¹¹. This will normally be the current market value of the Covered Collateral comprising securities¹².
- (b) A secured party may not sell Covered Collateral to itself, either alone or with others, unless the sale is made by the court and the secured party has obtained leave to bid. This is because such a transaction would amount to foreclosure without the leave of the court. In addition, there is a broader policy basis for the rule, which is that a person should not put himself in a position where his duty (in this case, to obtain the best price reasonably available) and his interest (in this case, to pay as low a price as possible) conflict.
- (c) It is established that a secured party may sell mortgaged property to a company in which it has an interest, provided that it can prove that the sale was in good faith and that it had

¹⁰ If the Covered Agreement were governed by the laws of the British Virgin Islands there would be a degree of tension between the FCM's right to use the charged property and the customer's "equity of redemption" in the Covered Collateral, as the right of use might be construed as constituting a "clog on the equity of redemption" or otherwise an "unlawful collateral advantage". The position in the British Virgin Islands with regard to this issue is the same as the position under English law.

¹¹ *Cuckmere Brick Co Ltd v Mutual Finance Ltd* [1972] Ch 949; 2 All ER 633

¹² *Downsview Nominees Ltd v First City Corporation Ltd* [1993] AC 295

taken reasonable steps to obtain the best price reasonably obtainable at that time¹³. A *fortiori*, a secured party may sell mortgaged property to an affiliated company, subject to the same proviso.

11. *Are there any laws or regulations in your jurisdiction that would limit or distinguish a creditor's enforcement rights with respect to the security interest in any type of Covered Collateral depending on (a) the type of transaction underlying the creditor's exposure, (b) the type of Collateral or (c) the nature of the creditor or the debtor? For example, are there any types of "statutory liens" that would be deemed to take precedence over a security interest?*

2.37 There are no laws or regulations in the British Virgin Islands that would limit or distinguish a creditor's enforcement rights with respect to the type of security interest.

2.38 There are statutory "preferential claims" in the British Virgin Islands which may have preference over floating charges. These include employees' wages up to US\$10,000 each, certain amounts due to the British Virgin Islands Social Security Board up to an unlimited amount, certain amounts due in respect of employee health insurance or pension contributions up to US\$5,000 each, amounts due to the British Virgin Islands government up to US\$50,000 and sums due to the British Virgin Islands Financial Services Commission in respect of fees or penalties up to US\$20,000. In practice such preferential claims are not likely to be significant.

12. *How would your response to questions 10 and 11 change, if at all, assuming that an insolvency proceeding above has occurred with respect to the FCM (notwithstanding that the Covered Agreement may not provide for any events of default in respect of the FCM) rather than or in addition to the Covered Customer (for example, would this affect this ability of the FCM to enforce its security interest in Covered Collateral)?*

2.39 The occurrence of insolvency proceedings with respect to the FCM would not change our responses.

Enforcement of the security interest in Covered Collateral after the commencement of an insolvency proceeding

Note the additional assumption in the Instructions which applies to questions 13 to 15 below.

13. *How are competing priorities between creditors determined in your jurisdiction? What conditions must be satisfied if the FCM's security interest in each type of Covered Collateral is to have priority over all other claims (secured or unsecured) of an interest in the Covered Collateral?*

2.40 A British Virgin Islands court would apply British Virgin Islands rules¹⁴ as summarised below to questions of priority.

2.41 *BVIBCs and 2017 Limited Partnerships*

(a) A charge entered in the Register of Relevant Charges has priority over any subsequent charge.

¹³ *Farrars v Farrars Ltd* (1888) 40 ChD 395

¹⁴ We note that there is a possibility that a British Virgin Islands court would not consider itself the appropriate forum for enforcement proceedings in respect of collateral located outside the British Virgin Islands. Therefore, it will be a matter for the conflict of laws rules applicable in the jurisdiction in which enforcement is sought as to whether British Virgin Islands priority rules would be relevant. Further, even if the British Virgin Islands court accepts such jurisdiction, as ultimate enforcement proceedings in respect of the collateral will by necessity take place in the jurisdiction of the location of the asset, it will be a matter for the conflict of laws rules applicable in such jurisdiction as to whether British Virgin Islands priority rules or a British Virgin Islands court judgment based on British Virgin Islands priority rules would be relevant to enforcement.

- (b) Priorities between unregistered security interests are determined by the common law. However where a British Virgin Islands court would apply common law rules (as opposed to the statutory priority rules), they would also look to other principles of substantive law. Therefore in practice, the issues raised by the common law rules would prove academic as a British Virgin Islands court would defer questions of priority to the *lex situs* through application of conflict of laws rules.
- (c) The order of priorities is subject to the express consent of the holder of a prior charge or agreement between creditors.
- (d) A registered floating charge is postponed to a subsequently registered fixed charge unless the floating charge contains a prohibition or restriction on the power of the entity to create any future charge ranking in priority to or equally with the charge¹⁵.

2.42 IBCs

Charges created by a BVIBC in its previous corporate form as an International Business Company (**IBC**) are subject to the priority rules applicable to IBCs.

- (a) Fixed security took priority over floating security save for cases described in (c) below.
- (b) Security interests created before 1 January 1991 had priority over all security interests created on or after 1 January 1991 and as between themselves ranked in order of creation.
- (c) Where an IBC created a register of mortgages, charges and other encumbrances (an **IBC Register of Charges**), all security interests recorded in the IBC Register of Charges took priority over all security interests which had not been entered in the IBC Register of Charges (except for security interests created prior to 1 January 1991) and as between themselves ranked in order of their entry into the IBC Register of Charges, whether fixed or floating.
- (d) Priorities between unregistered security interests created on or after 1 January 1991 were determined by the common law rules and therefore the comments at paragraph 2.41(b) above apply.

2.43 Transitional priority rules for a BVIBC that was formerly an IBC

Priority of charges between those created by a BVIBC and those created by a BVIBC in its previous corporate form as an IBC are a matter for transitional provisions.

- (a) Charges registered in the IBC Register of Charges take priority over subsequent charges.
- (b) Our view as to the priority between unregistered charges created by a BVIBC in its previous corporate form as an IBC and charges entered in the Register of Registered Charges under the BVIBC regime is that, notwithstanding registration in the Register of Registered Charges, priority is determined in accordance with the common law rules and therefore the comments at paragraph 2.41(b) above apply.

Note that the transitional provisions provide that a charge created by a BVIBC in its previous corporate form as an IBC may be entered in the Register of Registered Charges and take priority in accordance with the BVIBC regime.

¹⁵ Although there is no way of definitively determining the existence of other security interests as a matter of British Virgin Islands law, as a practical matter we do not believe there is any way in which a third party could have a fixed charge over Covered Collateral credited to an account held with the FCM or a DCO without their knowledge or consent.

2.44 Other entities

There is no registration regime under British Virgin Islands statute in respect of trusts or partnerships other than 2017 Limited Partnerships and we believe that a British Virgin Islands court would apply common law principles to questions of priority and therefore the comments at paragraph 2.41(b) above apply.

14. *Would the FCM's enforcement of its security interest in any type of Covered Collateral be subject to any stay, moratorium or freeze or otherwise be affected by commencement of the insolvency (that is, how does the institution of an insolvency proceeding change your response to question 10 above, if at all)?*

2.45 The FCM's enforcement of its security interest would not be subject to any stay, moratorium or freeze or otherwise be affected by commencement of the insolvency of the customer.

2.46 Although the position is reinforced if the Covered Agreement constitutes a netting agreement for the purposes of Part XVII, assets subject to a security interest will in any case fall outside the estate available to a liquidator and, subject to the provisions on administration coming into force and the rules on voidable transactions, there is no provision of British Virgin Islands law which would provide grounds for a stay on enforcement.

15. *Will the Covered Customer (or its administrator, provisional liquidator, conservator, receiver, trustee, custodian or other similar official) be able to recover any transfers of Covered Collateral consisting of cash or securities made to the FCM during a certain "suspect period" preceding the date of the insolvency as a result of such a transfer constituting a "preference," fraudulent transfer or transaction at an undervalue (however called and whether or not fraudulent) in favour of the FCM or on any other basis? If so, how long before the insolvency does this suspect period begin? Would the posting of additional margin (which could be required when an Account's net liquidating equity has fallen below the required margin level for the Account due to trading losses in respect of one or more Covered Transactions) during the suspect period be subject to avoidance, either because the Covered Collateral was considered to relate to an antecedent or pre-existing obligation or for some other reason?*

2.47 British Virgin Islands law has provisions for voidable transactions which are summarised in Schedule 3. However it is highly unlikely that a British Virgin Islands court would hold as void a transaction entered into for *bona fide* commercial reasons and at arms' length by each of the parties and with no intent to defraud creditors.

2.48 The position is reinforced if the Covered Agreement constitutes a netting agreement for the purposes of Part XVII, which provides that, notwithstanding anything contained in the Insolvency Act or in any rule of law relating to insolvency, "the provisions relating to netting, the set off of money provided by way of security, the enforcement of a guarantee and the enforcement of a collateral arrangement and the set off of the proceeds thereof, as contained within a netting agreement or a guarantee provided for in such agreement shall be legally enforceable against a party to the agreement and where applicable, against a guarantor or other person providing security". The Insolvency Act defines netting agreement as an agreement "in relation to present or future financial contracts", the (presumably unintended) consequence being that if financial contracts have been entered into before 16 August 2004 (the effective date of the Insolvency Act) it would take a further financial contract to bring the netting agreement within the scope of the Insolvency Act. Otherwise, the Insolvency Act is clear on its face that a netting agreement is legally enforceable against a party notwithstanding that it constitutes a preference, an undervalue transaction, a voidable floating charge or an extortionate credit transaction.

2.49 The posting of additional margin during the suspect period would not be subject to avoidance assuming it relates to a contractual obligation from before the commencement of the suspect period.

Note the additional assumption in the Instructions which applies to question 16 below.

16. Assuming that (a) pursuant to the laws of your jurisdiction, the laws of another jurisdiction govern the creation and/or perfection of the security interest (for example, because such Covered Collateral is Located or deemed Located outside your jurisdiction) and (b) the FCM has obtained a valid and perfected security interest under the laws of such other jurisdiction, are there any formalities, notification requirements or other procedures, if any, that the FCM must observe or undertake in your jurisdiction in enforcing its security interest in Covered Collateral?

2.50 No.

Additional considerations

17. Are there any other local law considerations that you would recommend the FCM to consider in connection with enforcing its security interest in Covered Collateral?

2.51 No.

18. Are there any other circumstances you can foresee that might affect the FCM's ability to enforce its security interest in the Covered Collateral in your jurisdiction?

2.52 No.

Yours faithfully

A handwritten signature in blue ink, appearing to read "Henry Westwood & Riegels", with a long horizontal flourish extending to the right.

Harney Westwood & Riegels

APPENDIX A

CUSTOMER TYPES¹⁶

Description	Covered by opinion	Legal form(s)
<p><u>Bank/Credit Institution</u>. 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 <u>only</u> 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 (<i>EC</i>) 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 (<i>UK</i>)).</p>	Yes.	BVIBCs ¹⁷ regulated by the Banks and Trust Companies Act 1990.
<p><u>Central Bank</u>. 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).</p>	Not applicable.	
<p><u>Corporation</u>. A legal entity that is organized as a corporation or company rather than a partnership, is</p>	Yes.	BVIBCs (including SPCs ¹⁸ and restricted purposes companies ¹⁹).

¹⁶ In these definitions, the term “legal entity” means an entity with legal personality other than a private individual.

¹⁷ Companies incorporated, continued or re-registered under the BVI Business Companies Act 2004 (the *BVIBC Act*) and identified by any of the following in the last part of the name: “Limited”, “Corporation” or “Incorporated”, “Société Anonyme” or “Sociedad Anonima”, “Ltd”, “Corp”, “Inc” or “S.A.”, or in the case of an unlimited company “Unlimited” or “Unltd”, or any other word or words, or abbreviations thereof, as may be specified in any regulations promulgated under the BVIBC Act. This includes companies originally incorporated (i) under the International Business Companies Act (Cap 291) and re-registered under the BVI Business Companies Act either voluntarily before 30 November 2006 or automatically on 1 January 2007 or (ii) under the Companies Act (Cap 285) and re-registered under the BVI Business Companies Act either voluntarily before 1 January 2009 or automatically on 1 January 2009.

¹⁸ Segregated portfolio companies identified by inclusion in the name of the designation “Segregated Portfolio Company” or “SPC”. The assets and liabilities of segregated portfolio companies are compartmentalised and the segregated portfolios, although not separate legal entities, are treated as distinct entities for most (but not all) insolvency related purposes. The conclusions reached in this opinion are generally applicable to segregated portfolio companies except where indicated and provided there is no attempt to attribute the liabilities of one portfolio to the assets of a separate portfolio either prior to or after the onset of insolvency.

Description	Covered by opinion	Legal form(s)
engaged in industrial and/or commercial activities and does not fall within one of the other categories in this Appendix B.		
<u>Hedge Fund/Proprietary Trader</u> . 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.	BVIBCs (including SPCs) whether regulated by the Securities and Investment Business Act 2010 or not. These entities may also take the form of partnerships or unit trusts ²⁰ .
<u>Insurance Company</u> . 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.	Qualified ²¹ .	BVIBCs (including SPCs) regulated by the Insurance Act 2008.
<u>International Organization</u> . 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.	Not applicable.	
<u>Investment Firm/Broker Dealer</u> . 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	Yes.	BVIBCs regulated by the Securities and Investment Business Act 2010. These entities may also take the form

¹⁹ Restricted purposes companies identified by the designation “(SPV) Limited” or “(SPV) Ltd”. Unlike ordinary BVIBCs, restricted purposes companies have limitations on their powers set out in their memoranda and articles of association and actions taken outside those limitations may be *ultra vires*. Provided the entry into of an Agreement is within the powers of a restricted purposes company, the conclusions reached in this opinion are applicable to restricted purposes companies.

²⁰ British Virgin Islands trusts settled in the British Virgin Islands are regulated by the Trustee Act (Cap 303) (the **Trustee Act**) and where relevant the Virgin Islands Special Trusts Act 2003 (the **VISTA**). Trusts are not legal entities.

²¹ The Insurance Act 2008 provides that a British Virgin Islands insurance company “shall not invest or trade in a derivative without the prior written approval of the Financial Services Commission”. The Regulatory Code 2009 provides that as part of the application for an insurance license, the business plan should include among other things “any plans that the applicant has to purchase or sell derivatives” (a “derivative” being defined in the Regulatory Code as “an option, a future or a contract for differences”). Properly therefore such approval would have been obtained at the time of licensing. If an insurance company were to invest or trade in a derivative without consent, any agreement to that effect would be unenforceable against the counterparty under the Financial Services Commission Act, 2001. Note however that the agreement would still be enforceable against the insurance company by the counterparty, which would also be entitled to recover from the insurance company any money or other property paid or transferred by it under the agreement, as well as compensation for any loss.

Description	Covered by opinion	Legal form(s)
<p>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.</p>		<p>of partnerships or unit trusts.</p>
<p><u>Investment Fund</u>. 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.</p>	<p>Yes.</p>	<p>BVIBCs (including SPCs) whether regulated by the Securities and Investment Business Act 2010 or not.</p> <p>These entities may also take the form of partnerships or unit trusts.</p>
<p><u>Local Authority</u>. 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.</p>	<p>Qualified²².</p>	<p>BVIBCs.</p>

²² Whilst there are instances in which a transaction may be entered into for hedging purposes (which may well be an effective risk management strategy for a government department), there being no British Virgin Islands precedent in such matters we believe that a court in the British Virgin Islands may well take the view of the Law Lords in *Hazel v Hammersmith and Fulham London Borough Council* [1992] 2 AC 1 that a local authority had no power to enter into interest rate swap transactions with the object of making profit because of their speculative nature. We therefore recommend caution in respect of transactions with government entities in the British Virgin Islands as the act of entering into derivatives transactions, if found to be outside the powers of such bodies, may be unlawful.

Description	Covered by opinion	Legal form(s)
<p><u>Partnership</u>. 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).</p>	Yes.	<p>General Partnerships²³.</p> <p>1996 Limited Partnerships²⁴.</p> <p>2017 Limited Partnerships without Legal Personality²⁵.</p> <p>Limited Partnerships with Legal Personality²⁶.</p>
<p><u>Pension Fund</u>. 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.</p>	Yes.	<p>BVIBCs (including SPCs) whether regulated by the Securities and Investment Business Act 2010 or not.</p> <p>These entities may also take the form of partnerships or unit trusts.</p>
<p><u>Sovereign</u>. 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</p>	Qualified ²² .	BVIBCs.

²³ Formed or regulated under the Partnership Act 1996. General Partnerships are not legal entities and the partners do not have limited liability.

²⁴ Formed or regulated under the Partnership Act 1996. 1996 Limited Partnerships formed under the Partnership Act 1996 may be reregistered voluntarily as 2017 Partnerships without Legal Personality (or as 2017 Limited Partnerships with Legal Personality) under the Limited Partnership Act 2017. Any 1996 Limited Partnerships which have not been reregistered by 11 January 2028 will be automatically reregistered as 2017 Partnerships without Legal Personality under the Limited Partnership Act 2017 on 11 January 2028. 1996 Limited Partnerships are not legal entities.

²⁵ Formed, registered or reregistered under the Limited Partnership Act 2017. 1996 Limited Partnerships may be reregistered voluntarily as 2017 Limited Partnerships without Legal Personality (or as Limited Partnerships with Legal Personality) under the Limited Partnership Act 2017.

²⁶ Formed, registered or reregistered under the Limited Partnership Act 2017. Partnerships formed under the Partnership Act 1996 may be reregistered voluntarily as Limited Partnerships with Legal Personality (or as 2017 Limited Partnerships without Legal Personality) under the Limited Partnership Act 2017.

Description	Covered by opinion	Legal form(s)
<p>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”).</p>		
<p><u>Sovereign Wealth Fund</u>. 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.</p>	Not applicable.	
<p><u>Sovereign-Owned Entity</u>. 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”).</p>	Qualified ²² .	BVIBCs.
<p><u>State of a Federal Sovereign</u>. 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.</p>	Not applicable.	

SCHEDULE 1

Additional Assumptions

- 1 The Covered Agreement constitutes valid, binding and enforceable obligations in accordance with their express terms under New York law, and the New York courts would accept the calculation of delivery values upon the happening of an Event of Default as a genuine and *bona fide* pre-estimate of a party's loss, and would not construe those provisions as a penalty.
- 2 Each party has all requisite capacity and corporate power to execute, deliver and perform its obligations under the Covered Agreement (and we draw your attention to certain limitations on capacity of specific types of entities outlined in Appendix B) and has taken all necessary steps to authorise, execute, deliver and perform the Covered Agreement and all Covered Transactions.
- 3 Any Base Account Agreement and CDA conform in all respects to the description of them in Annex 1 and have not been extended or modified in any way inconsistent with Annex 1.
- 4 The Covered Agreement is entered into for *bona fide* commercial reasons and at arms' length by each of the parties and with no intent to defraud creditors.
- 5 The Covered Agreement and all Covered Transactions are entered into prior to the commencement of Insolvency Proceedings (as defined in Schedule 2) in respect of the Covered Customer²⁷.
- 6 At the time at which a Covered Transaction is entered into under the Covered Agreement, neither party has actual notice of the insolvency of the other party.
- 7 No provision of any law (other than British Virgin Islands law) affects the opinions stated herein.
- 8 Subject to our comments in respect of partnerships and trusts, all obligations under the Covered Agreement are mutual between the parties in the sense that there are only two parties and each is personally liable as regards obligations owing by it and is beneficial owner of the obligations owed to it.

²⁷ Any Covered Transactions entered into after Insolvency Proceedings have commenced in relation to a BVIBC are void unless the court otherwise orders, as the BVIBC does not have capacity to contract.

SCHEDULE 2

Insolvency Proceedings

1 Insolvency

1.1 The primary legislation governing bankruptcy and insolvency proceedings in the British Virgin Islands is the Insolvency Act 2003 (the **Insolvency Act**).

1.2 Except where otherwise defined, **insolvent** in relation to an insolvent party means:

- (a) it fails to comply with a statutory demand for payment served on it in accordance with the provisions of Part V of the Insolvency Act;
- (b) execution or process issued on a judgment, decree or order of a British Virgin Islands court in favour of a creditor is returned wholly or partly unsatisfied;
- (c) the value of the insolvent party's liabilities exceed its assets (the **balance sheet test**); or
- (d) the insolvent party is unable to pay its debts as they fall due (the **cash flow test**).

2 Companies

2.1 The only bankruptcy, composition, rehabilitation or other insolvency proceedings to which a party incorporated in or with a branch in the British Virgin Islands would be subject in the British Virgin Islands are:

- (a) supervised creditors' arrangements under Part II (*Creditors' arrangements*) of the Insolvency Act;
- (b) receivership and administrative receivership²⁸ under Part IV (*Receivership*) of the Insolvency Act²⁹; and
- (c) liquidation under Part VI (*Liquidation*) of the Insolvency Act

(collectively **Insolvency Proceedings**).

In addition, Part III (*Administration*) of the Insolvency Act provides for administration. However this part has not been brought into force and administration is not considered an **Insolvency Proceeding** for the purposes of this opinion.

2.2 There are a number of additional reorganisational processes under British Virgin Islands law in respect of BVIBCs which are not necessarily related to the insolvency of the party. These are:

- (a) solvent voluntary liquidation, insolvent voluntary liquidation (in which case it is subject to the provisions of Part VI of the Insolvency Act) or dissolution under Part XII (*Liquidation, Striking-Off and Dissolution*) of the BVI Business Companies Act 2004 (the **BVIBC Act**);
- (b) a reorganisation under Part IX (Merger, Consolidation, Sale of Assets, Forced Redemptions, Arrangements and Dissenters) of the BVIBC Act; and

²⁸ An administrative receiver is a receiver of the whole, or substantially the whole, of the business, undertaking and assets of a company.

²⁹ Which also covers receivership under the Conveyancing and Law of Property Act (Cap 220).

(c) continuation under foreign law under Part X (*Continuation*) of the BVIBC Act.

2.3 Other than a requirement to notify the relevant regulatory body, there are no special provisions relating to banks, regulated funds or broker dealers. Insolvency proceedings for these entities are generally conducted in the same fashion as for unregulated entities of the same type.

2.4 The BVIBC Act contains certain additional provisions relating to the insolvency of segregated portfolio companies. Notwithstanding any other provision of British Virgin Islands law, a liquidator of a segregated portfolio company is bound to maintain the segregation of the portfolios and, in discharging the claims of creditors, may only apply the company's assets to those entitled to recourse to them under the segregated portfolio provisions of the BVIBC Act. The principles of segregation of portfolios are therefore maintained through insolvency. The BVIBC Act also contains provisions under which certain parties may apply to the court for a portfolio liquidation order in respect of a specific segregated portfolio and where relevant in this opinion the expression ***Insolvency Proceedings*** includes portfolio liquidation orders. The BVIBC Act further contains provision for administration orders in respect of individual segregated portfolios, effectively applying the provisions of Part III (*Administration*) of the Insolvency Act to segregated portfolios (once the relevant provisions have been brought into force).

3 Partnerships

2017 Limited Partnerships without Legal Personality

Limited Partnerships with Legal Personality

3.1 In relation to 2017 Limited Partnerships without Legal Personality and Limited Partnerships with Legal Personality, the Limited Partnership Act 2017 broadly provides that the Insolvency Act shall apply to such partnerships with any necessary changes³⁰. Accordingly, paragraph 1.1 above would broadly apply with equal effect to such partnerships.

General Partnerships

1996 Limited Partnerships

3.2 Section 499 of the Insolvency Act provides that the Insolvency Rules (the ***Rules***) will determine which provisions of the Insolvency Act apply to insolvent partnerships. To date only one set of Rules has been promulgated, the Insolvency Rules 2005. However, these do not address the position in relation to insolvent partnerships. Neither a General Partnership nor a 1996 Limited Partnership is a separate legal entity. They cannot be liquidated in the same manner as a Company, but it is possible to pursue claims in respect of the partnership against each person who was a member of the partnership at the relevant time. In the event that any partner is unable to satisfy the claims made against them the partner would be subject to insolvency proceedings under British Virgin Islands law in the usual way³¹.

3.3 The courts of the British Virgin Islands do have jurisdiction to wind-up and dissolve such partnerships on various grounds, including:

(a) when the business of the partnership can only be carried on at a loss; and

³⁰ The main relevant difference is that there is a different test for "insolvency" from that which applies to Companies.

³¹ The Partnership Act 1996 actually provides that the provisions of the Companies Act relating to winding-up and dissolution ... shall apply *mutatis mutandis* to the winding-up of the limited partnership. The provisions of the Companies Act relating to winding-up and dissolution were repealed by the Insolvency Act, and, while the Partnership Act 1996 was not amended, under normal provisions of statutory interpretation it must be assumed that the references would be construed as references to the Insolvency Act.

- (b) whenever circumstances have arisen which, in the opinion of the court, render it just and equitable that the partnership be dissolved.

However the court will only hear an application on these grounds from a partner, not a third party. Further there is nothing in British Virgin Islands law at present that would enable the court to wind up a partnership itself (as distinct from any partners) on the basis that the partnership was insolvent on the basis of the cash flow test or the balance sheet test.

- 3.4 If any individual partner of a General Partnership or a 1996 Limited Partnership has been declared bankrupt (for an individual) or has gone into insolvent liquidation (for a company), then the partnership will be dissolved. If upon the dissolution of the partnership it is unable to pay the partnership debts as they fall due, then in the case of a 1996 Limited Partnership the winding up and dissolution of the partnership proceeds as if the partnership was an insolvent company. There is no present guidance under British Virgin Islands law as to how the winding-up and dissolution of an insolvent General Partnership could be conducted. In comparable common law jurisdictions courts have sometimes resorted to the fiction of treating the insolvent partnership as a quasi person in order to maintain an orderly distribution amongst creditors, but there is no statutory basis upon which such a procedure might be based.
- 3.5 Because the position with respect to 1996 Limited Partnerships is much less satisfactory than that for Limited Partnerships with Legal Personality or even 2017 Limited Partnerships without Legal Personality, our recommendation when dealing with Counterparties who are 1996 Limited Partnerships would be to require that they re-register under the Limited Partnership Act.

4 Trusts and unit trusts

- 4.1 Trusts may be terminated under the terms of the trust, by unanimous agreement of the beneficiaries or on the order of a court.

SCHEDULE 3

Voidable Transactions

- 1 Under British Virgin Islands law, certain transactions may be set aside or otherwise varied or amended by orders of the British Virgin Islands court upon the application of a liquidator or administrator when an insolvent party goes into liquidation or into administration. Principally these are where the transaction is an unfair preference, an undervalue transaction, a voidable floating charge or an extortionate credit transaction.
- 2 Unfair preferences, undervalue transactions, voidable floating charges and extortionate credit transactions are all regulated by the Insolvency Act and in each case the transaction must have been entered into within the relevant vulnerability period, being the period prior to the onset of insolvency³² or the making of the administration order and (except in the case of extortionate credit transactions) the transaction must either (a) have been entered into at a time that the insolvent party was insolvent or (b) have caused the insolvent party to become insolvent, for which purposes insolvent excludes insolvent under the balance sheet test.
- 3 An unfair preference is a transaction that has the effect of putting a creditor into a position which, in the event of the insolvent party going into insolvent liquidation, would be better than the position in which that creditor would have been vis-à-vis other creditors of the insolvent party if the transaction had not been entered into. A transaction is not an unfair preference if it took place in the ordinary course of the insolvent party's business. The relevant vulnerability period is six months, except if the creditor is a connected person³³, in which case it is two years.
- 4 An undervalue transaction is a transaction where the insolvent party makes a gift or otherwise receives no consideration for the transaction, or the value of the consideration that it receives in money or money's worth is considerably less than the consideration provided to the insolvent party. A transaction is not an undervalue transaction if the insolvent party enters into the transaction in good faith and for the purposes of its business and if at the time it entered into the transaction there were reasonable grounds for believing that the transaction would benefit the insolvent party. The relevant vulnerability period is six months, except if the creditor is a connected person, in which case it is two years.
- 5 A floating charge may be set aside if there was no consideration at the same time or subsequent to the creation of the charge. The relevant vulnerability period is six months, except if the creditor is a connected person, in which case it is two years.
- 6 An extortionate credit transaction is a transaction for or involving the provision of credit and, having regard to the risk accepted by the person giving credit, (a) the terms of such credit extension are such as to require grossly exorbitant payments to be made (either unconditionally or in certain contingencies) or (b) the transaction otherwise grossly contravenes ordinary principles of fair trading. The relevant vulnerability period is five years.

³² For which purposes "insolvency" means (a) it fails to comply with the requirements of a statutory demand that has not been set aside, (b) execution or other process issued on a judgment, decree or order of a British Virgin Islands court in favour of a creditor of the company is returned wholly or partly unsatisfied or (c) the company is unable to pay its debts as they fall due.

³³ In relation to a company, "connected person" means any one or more of: (a) a promoter of the company; (b) a director or member of the company or of a related company; (c) a beneficiary under a trust of which the company is or has been a trustee; (d) a related company; (e) another company one of whose directors is also a director of the company; (f) a nominee, relative, spouse or relative of a spouse of a person referred to in (a) to (c); (g) a person in partnership with a person referred to in (a) to (c); and (h) a trustee of a trust having as a beneficiary a person who is, apart from this paragraph, a connected person. A company is related to another company if (a) it is a subsidiary or holding company of that other company; (b) the same person has control of both companies; and (c) the company and that other company are both subsidiaries of the same holding company.

- 7 In addition, any conveyance made by any person with intent to defraud creditors is voidable at the instance of the person thereby prejudiced under British Virgin Islands law. It is not a requirement that the relevant transaction was entered into at time when one party was insolvent or became insolvent as a result of the transaction. It is not a requirement that the transferring party subsequently went into liquidation or administration and the right to challenge is not limited to a liquidation. However, no conveyance entered into for valuable consideration and in good faith to a person who did not have notice of the intention to defraud may be impugned.

SCHEDULE 4

Set-Off and Netting

- 1 Insolvency set-off is regulated under Part V (*Provisions applicable to the liquidation of companies and the bankruptcy of individuals*) of the Insolvency Act and is applicable to BVIBCs, foreign companies and individuals. Specifically Section 150 provides for automatic set-off of mutual credits and debts incurred prior to the commencement of liquidation.
- 2 Part XVII (*Netting and Financial Contracts*) of the Insolvency Act (**Part XVII**), based on the ISDA model netting act, provides that notwithstanding anything contained in the Insolvency Act, the insolvency rules promulgated under the Insolvency Act or in any rule of law relating to insolvency, provisions relating to netting and set off, as well as the enforcement of collateral arrangements and the set off of the proceeds thereof, as contained within a netting agreement are enforceable against each party to that contract.
- 3 Section 150 of the Insolvency Act is expressly made subject to Part XVII, and so if the insolvency set-off rules were to produce a different result from the netting provisions of a “netting agreement” the netting provisions would prevail.
- 4 A “netting agreement” is defined in Part XVII as an agreement between two parties only in relation to present or future financial contracts between them the provisions of which include the termination of those contracts for the time being in existence, the determination of the termination values of those contracts and the set-off of the termination values so determined so as to arrive at a net amount due.
- 5 For the purposes of Part XVII of the Insolvency Act, a financial contract is a contract, including any terms and conditions incorporated into any such contract, pursuant to which payment or delivery obligations that have a market or an exchange price are due to be performed at a certain time or within a certain period of time.
- 6 Without limiting the previous paragraph, the following are financial contracts:
 - (a) a currency, cross-currency or interest rate swap agreement;
 - (b) a basis swap agreement;
 - (c) a spot, future, forward or other foreign exchange agreement;
 - (d) a cap, collar or floor transaction;
 - (e) a commodity swap;
 - (f) a forward rate agreement;
 - (g) a currency or interest rate future;
 - (h) a currency or interest rate option;
 - (i) equity derivatives, such as equity or equity index swaps, equity options and equity index options;
 - (j) credit derivatives, such as credit default swaps, credit default basket swaps, total return swaps and credit default options;

- (k) energy derivatives, such as electricity derivatives, oil derivatives, coal derivatives and gas derivatives;
- (l) weather derivatives, such as weather swaps or weather options;
- (m) bandwidth derivatives;
- (n) freight derivatives;
- (o) carbon emissions derivatives;
- (p) a spot, future, forward or other commodity contract;
- (q) a repurchase or reverse repurchase agreement;
- (r) an agreement to buy, sell, borrow or lend securities, such as a securities lending transaction;
- (s) a title transfer collateral arrangement;
- (t) an agreement to clear or settle securities transactions or to act as a depository for securities;
- (u) any other agreement similar to any agreement or contract referred to in paragraphs (a) to (t) with respect to reference items or indices relating to (without limitation) interest rates, currencies, commodities, energy products, electricity, equities, weather, bonds and other debt instruments and precious metals;
- (v) any derivative or option in respect of, or combination of, one or more agreements or contracts referred to in paragraphs (a) to (u); and
- (w) any agreement or contract designated as such by the [British Virgin Islands Financial Services] Commission.

SCHEDULE 5

Orders in Aid of Foreign Insolvency Proceedings

- 1 Under Part XIX of the Insolvency Act, liquidators and representatives of other insolvency proceedings³⁴ taking place in designated territories³⁵ may apply to the British Virgin Islands court for assistance.
- 2 The British Virgin Islands court, when faced with such an application, shall do what will best ensure the economic and expeditious administration of the foreign proceedings to the extent that is consistent with certain guiding principles, specifically the just treatment of all persons claiming in the foreign proceedings, the protection of persons in the British Virgin Islands who have claims against the company against prejudice and inconvenience in the processing of claims in the foreign proceedings, the prevention of preferential or fraudulent disposition of property, the need for distributions to claimants in the foreign proceedings to be substantially in accordance with the order of distributions in a British Virgin Islands insolvency and comity.
- 3 The orders which the British Virgin Islands court can make in aid of the foreign proceedings are extremely wide and include the restraining of proceedings; orders requiring a person to deliver up the property of the company to the foreign representative, orders to facilitate the co-ordination of insolvency proceedings in the British Virgin Islands with the foreign insolvency proceedings and authorising the foreign representative of any person who could be examined in British Virgin Islands insolvency proceedings.
- 4 It seems that the provisions are wide enough for the British Virgin Islands court not only to render merely procedural assistance but also to apply substantive principles of British Virgin Islands insolvency law³⁶. The British Virgin Islands court has a discretion whether to apply the law of the British Virgin Islands or the law applicable to the foreign proceedings³⁷. However, set-off and preferential creditors are protected from this provision in that the court order cannot affect the right of any creditor to benefit from the set-off provisions in Section 150 of the Insolvency Act, or result in a preferential creditor receiving less than he would under a British Virgin Islands insolvency, without the consent of such person.
- 5 Note that provisions in Part XVIII of the Insolvency Act based on the UNCITRAL Model Law on Cross-Border Insolvency for giving and seeking assistance in insolvency proceedings have not been brought into force.
- 6 Apart from the statutory provisions, a liquidator appointed under a foreign liquidation may apply to the British Virgin Islands court for relief on behalf of the company in liquidation and the British Virgin Islands court will recognise that liquidator's standing.

³⁴ Specifically "collective judicial or administrative proceedings in which the property and affairs of the debtor are subject to control or supervision by a foreign court". It is arguable that administrative receivership is not within the ambit of this definition because it is not a collective proceeding nor is the administrative receiver truly under the control or supervision of the court. See *Mann v Secretary of State for Employment* [1999] ICR 898, House of Lords, holding that receivership was not a collective satisfaction of creditors' claims and therefore not an insolvency proceeding for the purposes of an EC directive.

³⁵ Australia, Canada, Finland, Hong Kong, Japan, Jersey, New Zealand, United Kingdom and USA.

³⁶ See *Re BCCI (No. 9)* [1994] 2 BCLC 636 per Rattee J

³⁷ Section 467(5) of the Insolvency Act.

ANNEX 1

Summary Annex

ANNEX 2

Instructions