

London, 30 May 2018

FIA Legal Opinions

*Breakfast briefing on FIA clearing documentation
and legal opinions – Part III*

Speakers:

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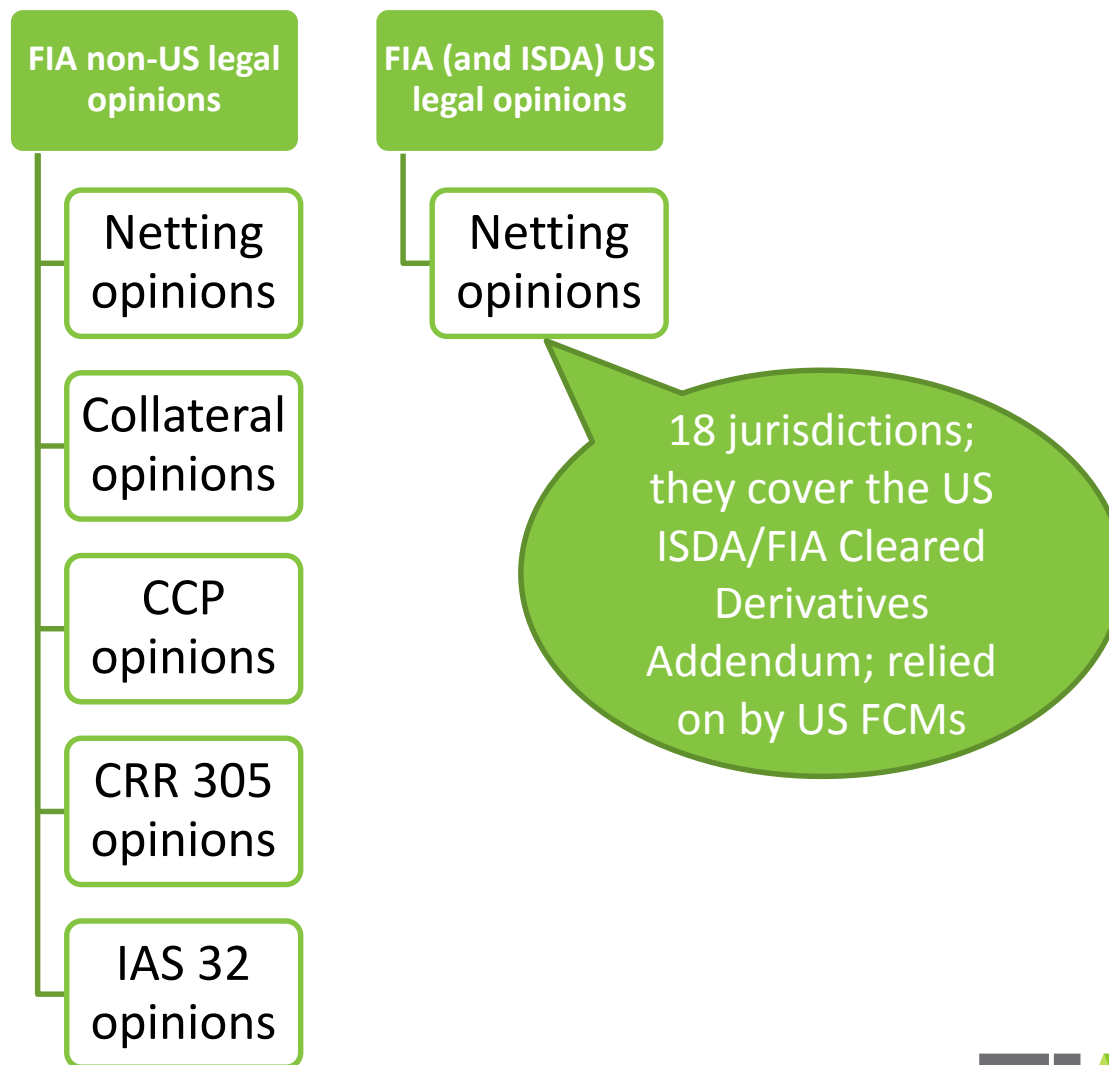
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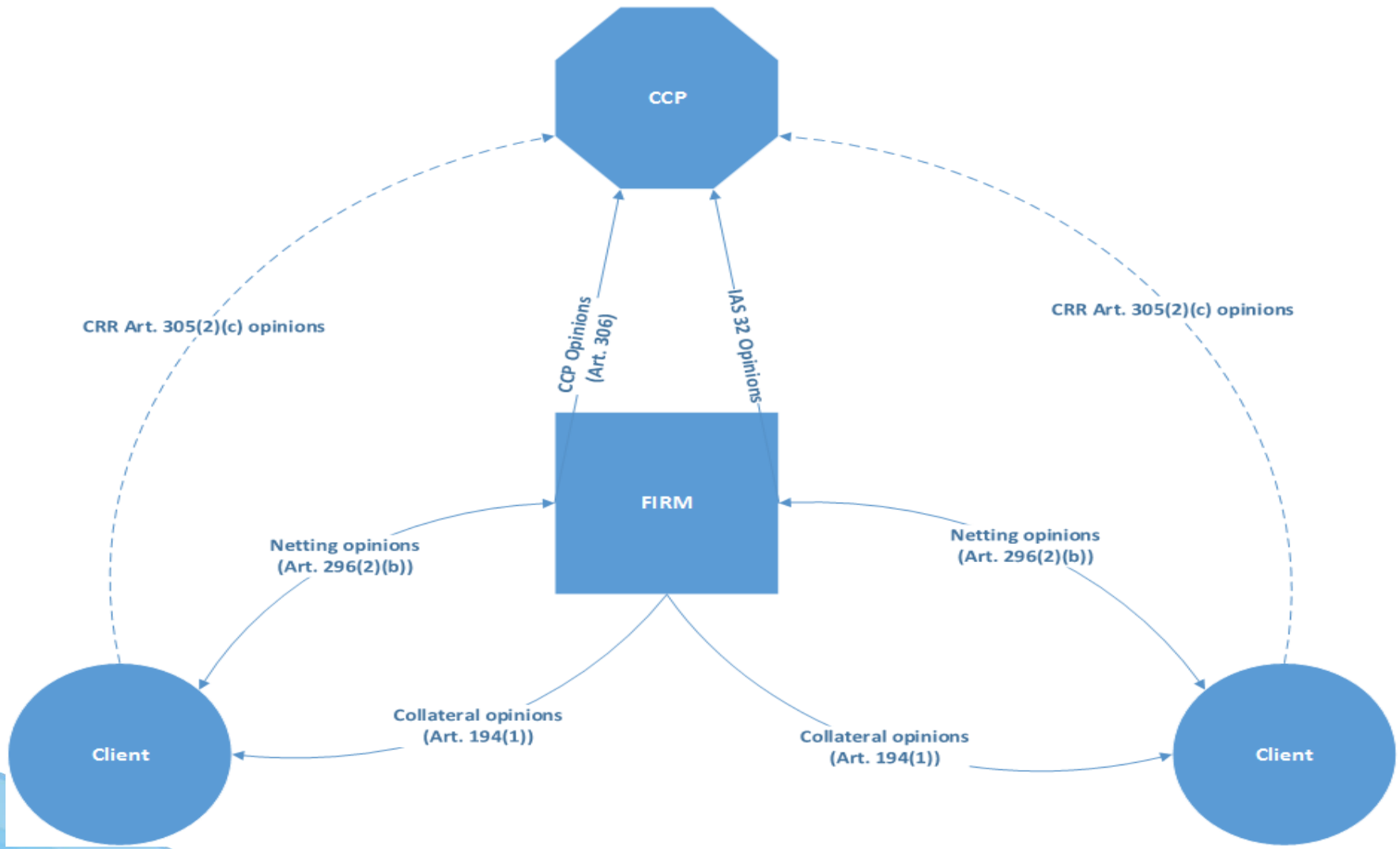
Agenda

- Introduction
- FIA Legal Opinions Library – Europe + US
- Legal opinion types that FIA maintains
- Looking back and ahead
- Capital requirements in the context of clearing – overview and types of opinion
- Netting and collateral opinions:
 - Templates – Category
 - Counterparty types
 - Core Provisions & Non-material Amendments
 - Netting flags
- Update process - NCCLs
- New access model
- Questions

FIA US and non-US legal opinions



FIA legal opinions library - Europe



High-level structure/scope of the FIA opinions

Netting opinions

- 34 Group A and 40 Group B opinions
- Two new templates for opinions going forward
- One opinion letter with many legal opinions
- Netting
- Set-off
- TTCA
- Necessary/desirable amendments
- FIA Customer Agreement(s)
- FIA Clearing Module
- ISDA/FIA Addendum
- ***New* 2018 ToBs - Core Provisions**

Collateral opinions

- 34 Group A and 40 Group B opinions
- Two new templates for opinions going forward
- Effectiveness of FIA security interest arrangements
- TTCA covered in the netting opinions
- ***New* 2018 ToBs - Core Provisions**

CCP opinions

- Originally obtained 46 CCP opinions
- Not all CCP opinions have been updated since
- Legal opinion + CRR Questionnaire for some major EU CCPs
- Enhanced template / phasing out questionnaire
- All CCP services typically covered
- Netting (including TT Margin/cash)
- Set off
- Account Segregation
- Bankruptcy remoteness of margin

CRR 305 opinions

- 3 CCP 305(2)(c) opinions and 3 CM 305(2)(c) opinions
- “bear no losses” conclusions
- Analysis of the “segregation condition”, “bankruptcy remoteness condition” and “porting condition” under 305(2)
- No FIA opinions available for 4% risk weighting under 305(3)

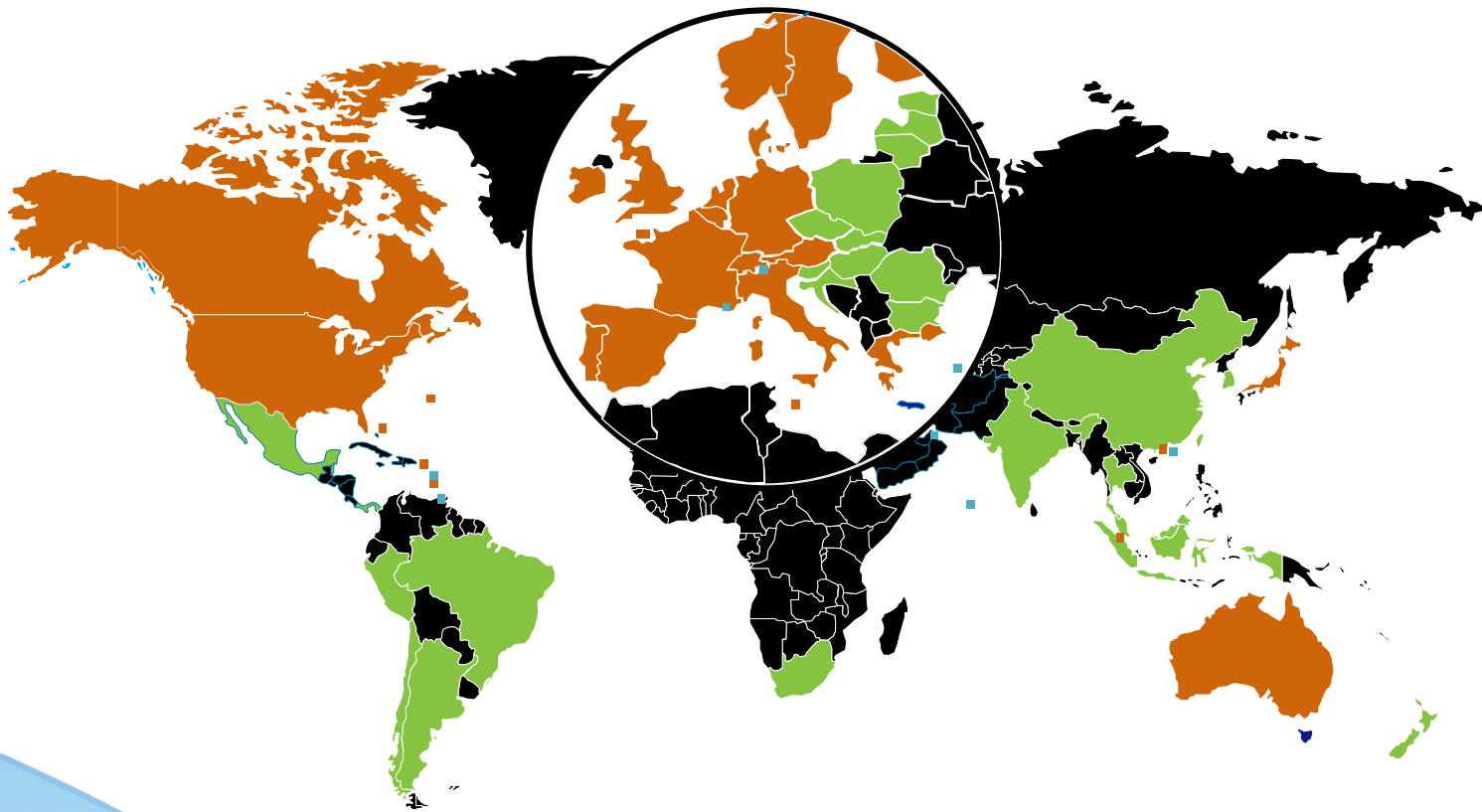
IAS 32 opinions

- 6 CCP opinions and 7 CM opinions
- A set of pre-opinions
- A set of documents on unilateral amendments of CCP Rules
- BAU payment netting
- Close-out netting in the event of CM’s and CCP’s default

Worldwide coverage

Group A: Australia, Austria, Bahamas, Belgium, Bermuda, British Virgin Islands, Canada – Quebec, Canada – Ontario, Cayman Islands, Denmark, England, Finland, France, Germany, Greece, Guernsey, Hong Kong, Ireland, Israel, Italy, Japan, Jersey, Luxembourg, Malta, Netherlands, Norway, Portugal, Scotland, Singapore, Spain, Sweden, Switzerland, Turkey, USA

Group B: Anguilla, Bahrain, Barbados, Belize, Brazil, Bulgaria, Chile, China, Croatia, Curaçao, Cyprus, Czech Republic, DIFC, Egypt, Estonia, Gibraltar, Hungary, India, Indonesia, Jordan, Kuwait, Latvia, Liechtenstein, Lithuania, Macau, Malaysia, Mauritius, Mexico, Monaco, New Zealand, Panama, Peru, Poland, Romania, Slovakia, Slovenia, South Africa, South Korea, Taiwan, Thailand



Looking back and ahead

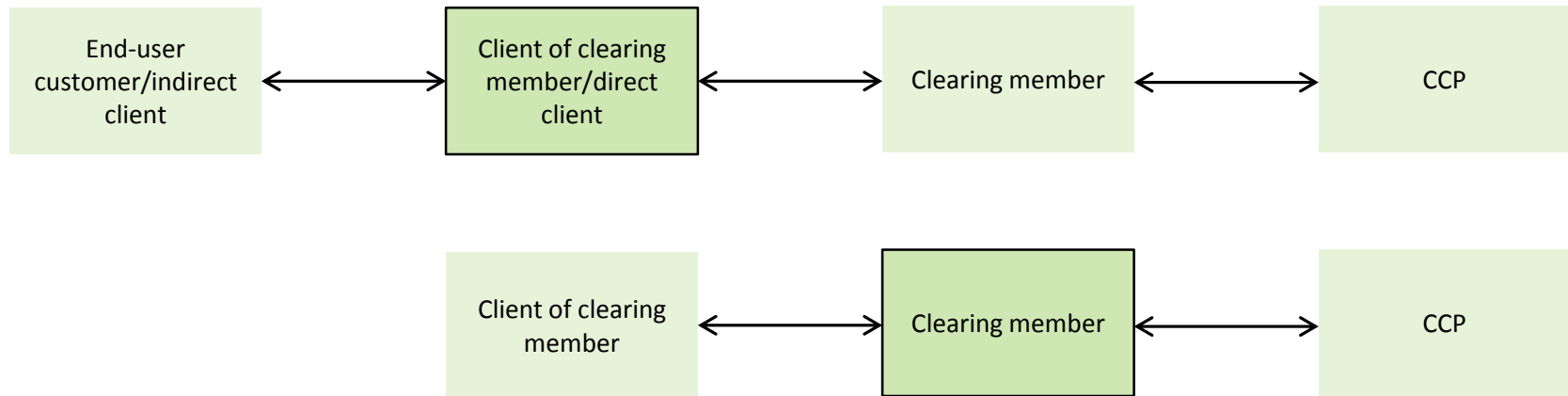
Last 24 months:

- Review of 34 Group A netting opinions - 13 NCCLs + 21 updates required (December 2015)
- Review of 40 Group B netting opinions - 18 NCCLs + 22 updates required (August 2016)
- Review of CCP 'interim opinions' (Dec 2013)
 - LCH.Clearnet Ltd, LCH.Clearnet SA, ECAG, ECC, ASX Clear, SGX, NOMX, ICE Clear Europe (March 2014), BM&F Bovespa (June 2014)
- 305 opinions (2%)
 - ICE Clear Europe and LME Clear 305 opinions added to the LCH Ltd 305 opinion
 - French CM and German CM 305 opinions added to the English CM 305 opinion
 - LCH Ltd 305 and English CM 305 opinions updated
- CCP 'refresher letters' and updated opinions
 - LCH.Clearnet Ltd (Dec 2015), LCH.Clearnet SA (Feb 2017), Eurex Clearing AG (Jan 2016), LME Clear (Jan 2018), ICE Clear Limited (Nov 2016)
 - Updates to Eurex Clearing and ECC opinions currently being produced
 - BME Clear opinion being provided
 - Review of ASX, CDCC, LCH.Clearnet Ltd., SGX and NOMX opinions (1 NCCL, others require updating)

Next 12 months:

- Opinion review and update process for netting, collateral and CCP opinions (see further details below)

Opinions in context: management of counterparty risk



Where does your firm stand in the chain: who is your counterparty (up- and down-stream)?

How can you be sure that your exposure is *net* if the counterparty fails?

First step: enter into a close-out netting agreement....

Capital requirements and accounting

Capital Requirements Regulation

- reinforces need for netting opinions for counterparty exposures
- introduces capital requirement for exposures to CCPs (not covered by the present project)
- allows capital relief for CMs where CCP defaults but CM is not liable to Client

Capital basics

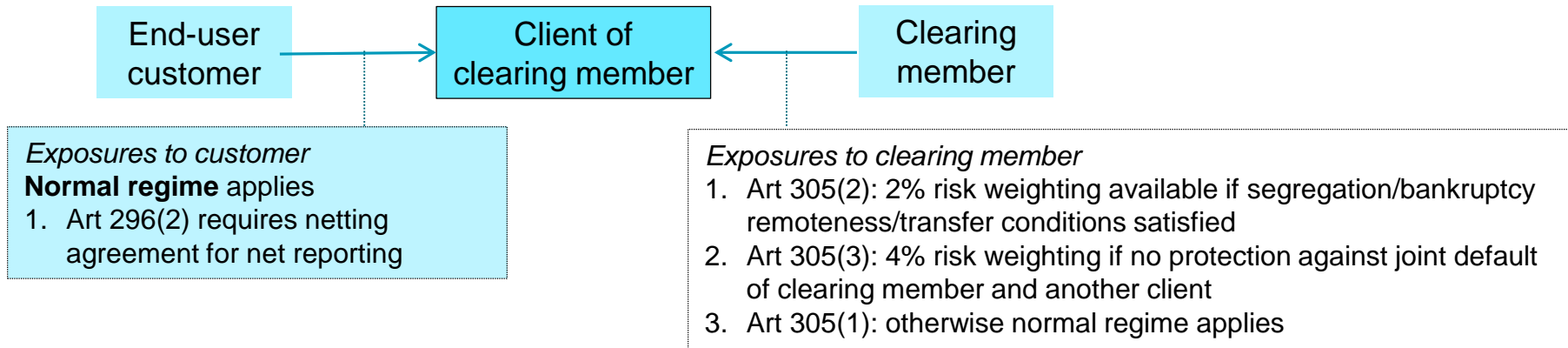
- Reg cap = [8]% * [risk weight] * [exposure]
- Risk weight differs according to counterparty identity
- Exposure may be net or gross

Accounting basics

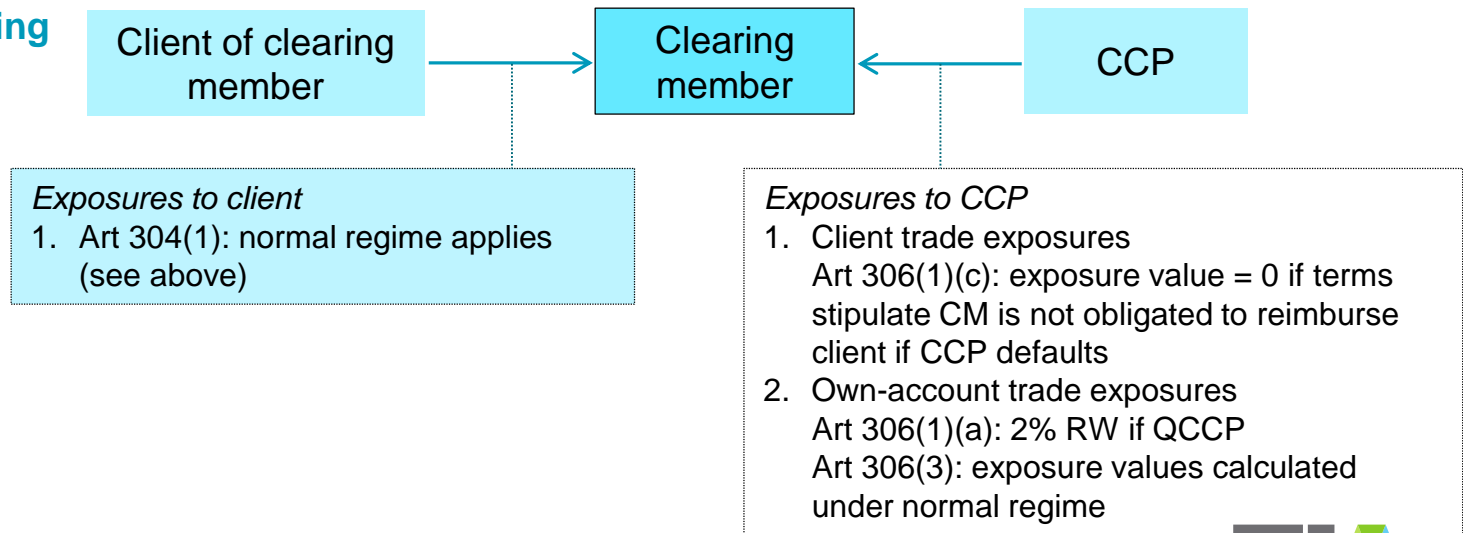
- Balance sheet asset may be reduced by liability
- Or maybe both asset and liability should be recognised on opposite sides of sheet

Capital requirements – exposures to clients

Position of client

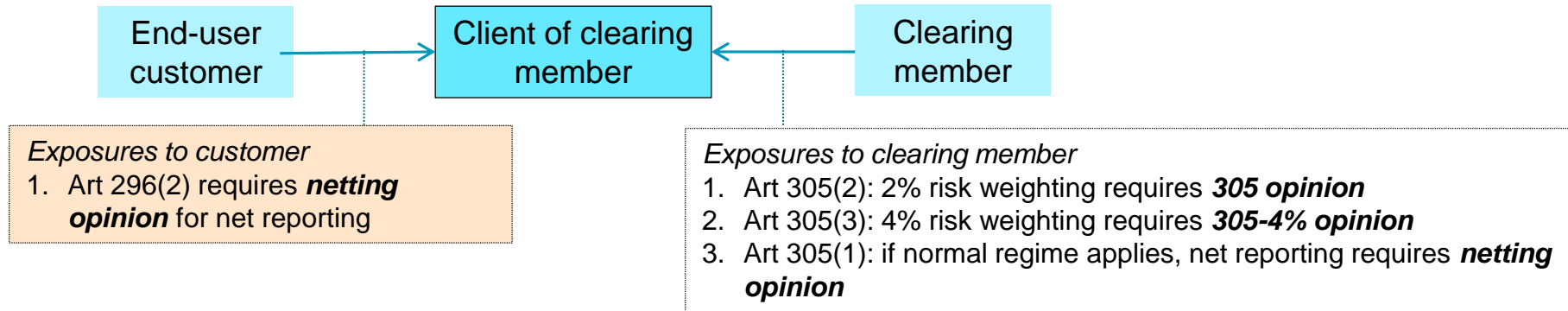


Position of clearing member

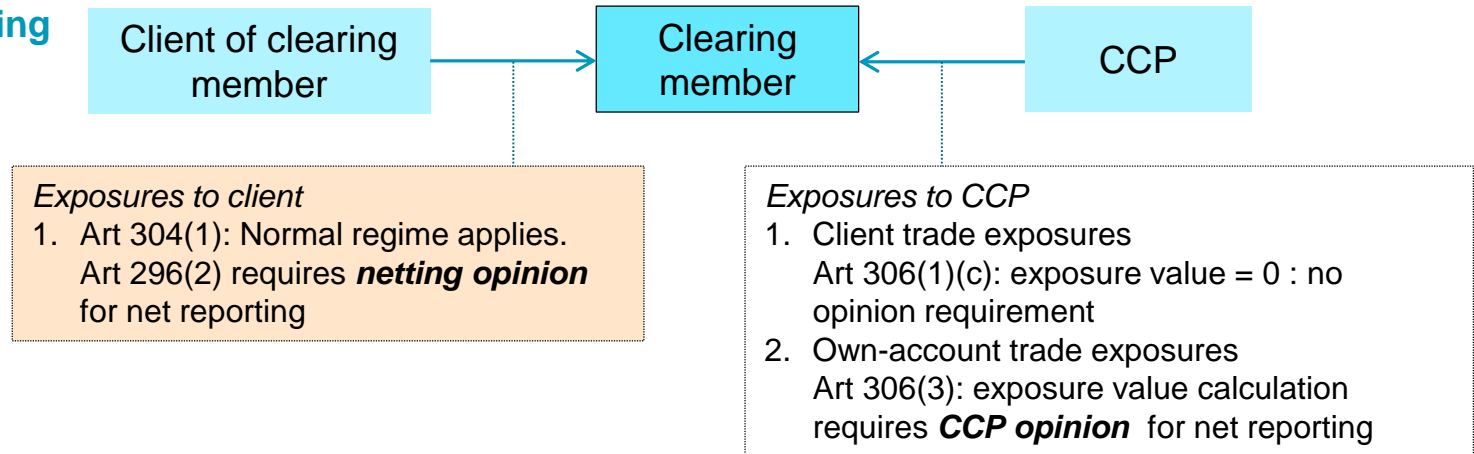


Capital requirements – netting opinions

Position of client

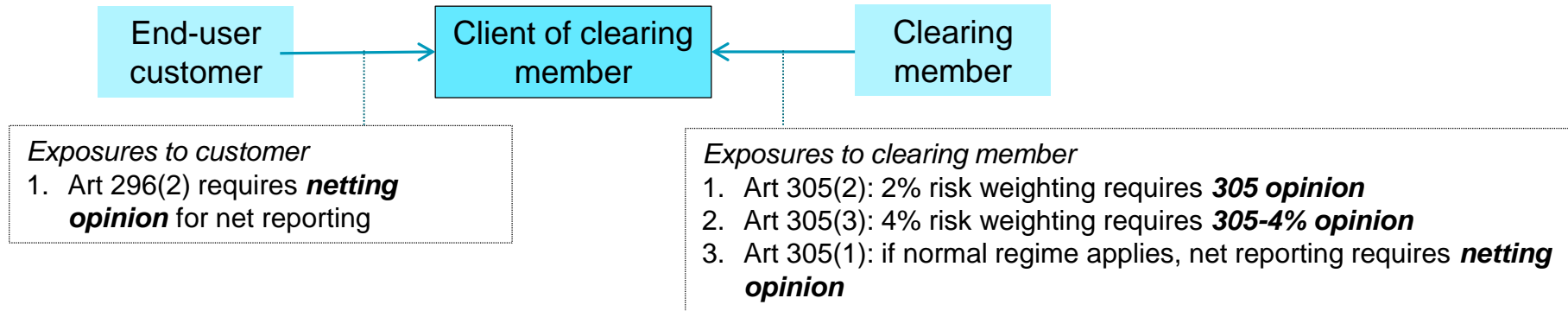


Position of clearing member

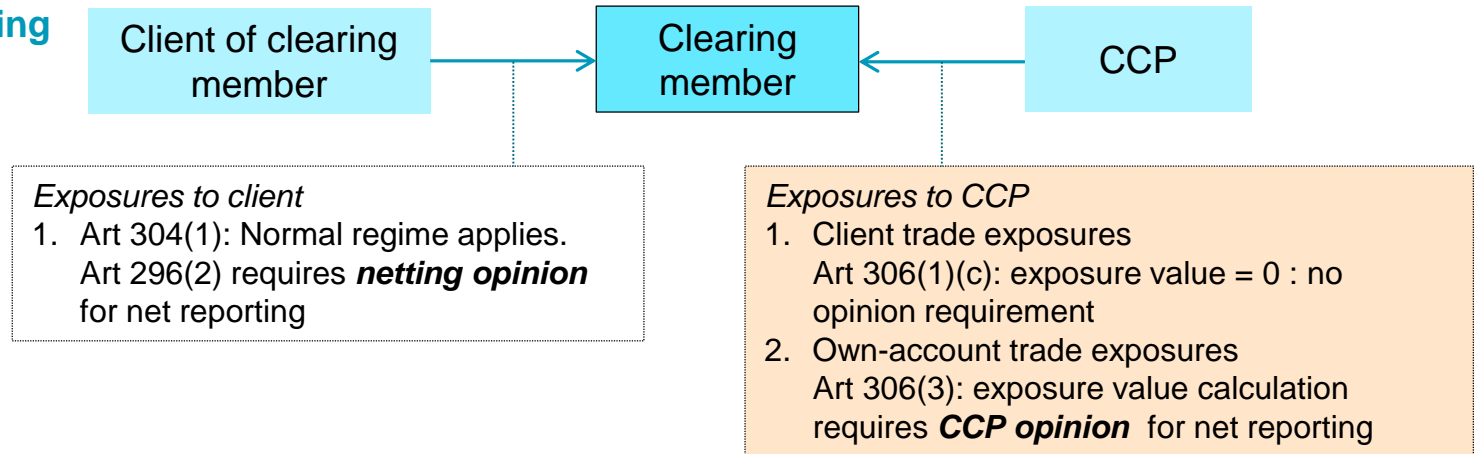


Capital requirements – CCP opinions

Position of client

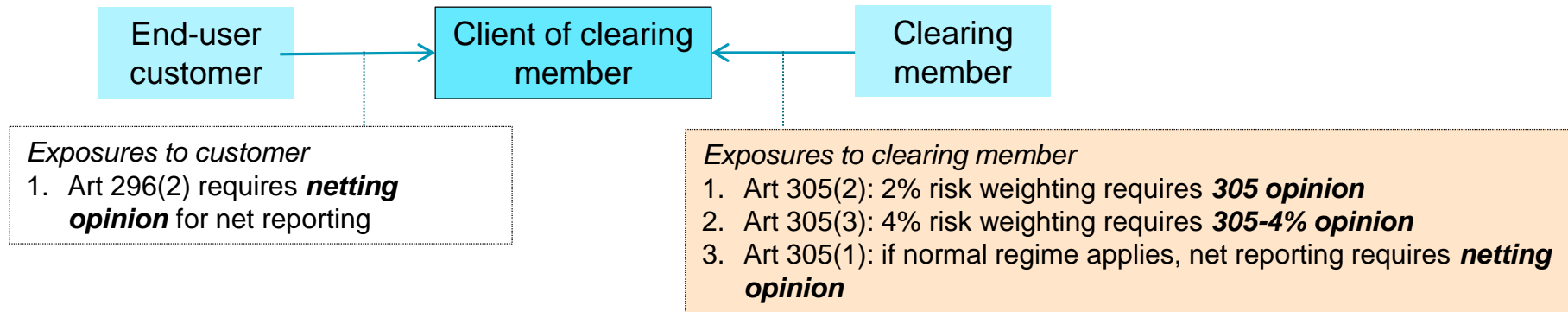


Position of clearing member

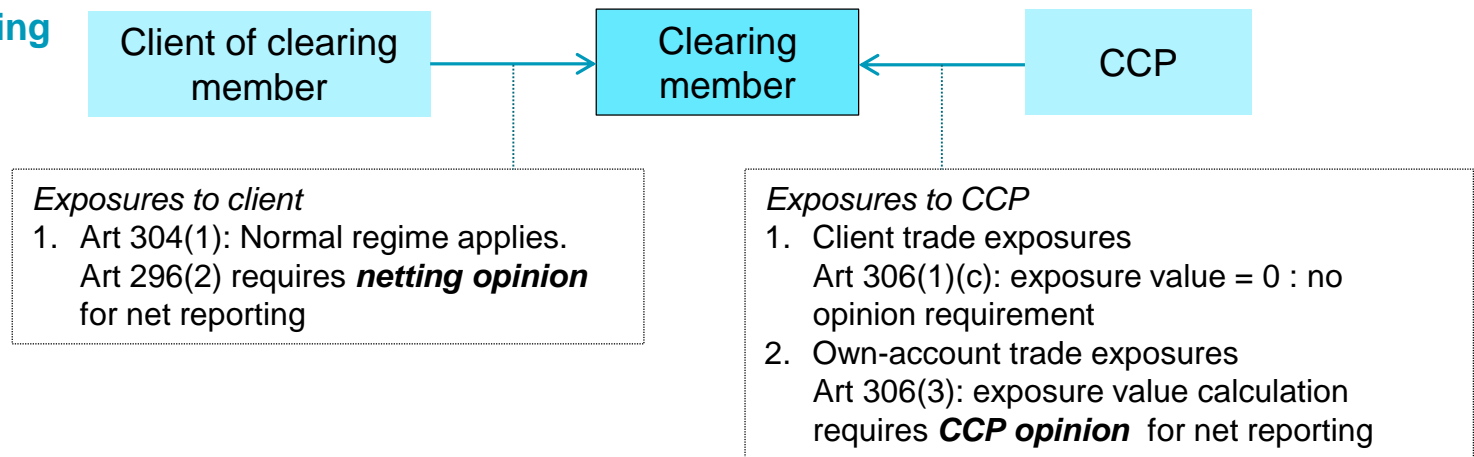


Capital requirements – 305 opinions

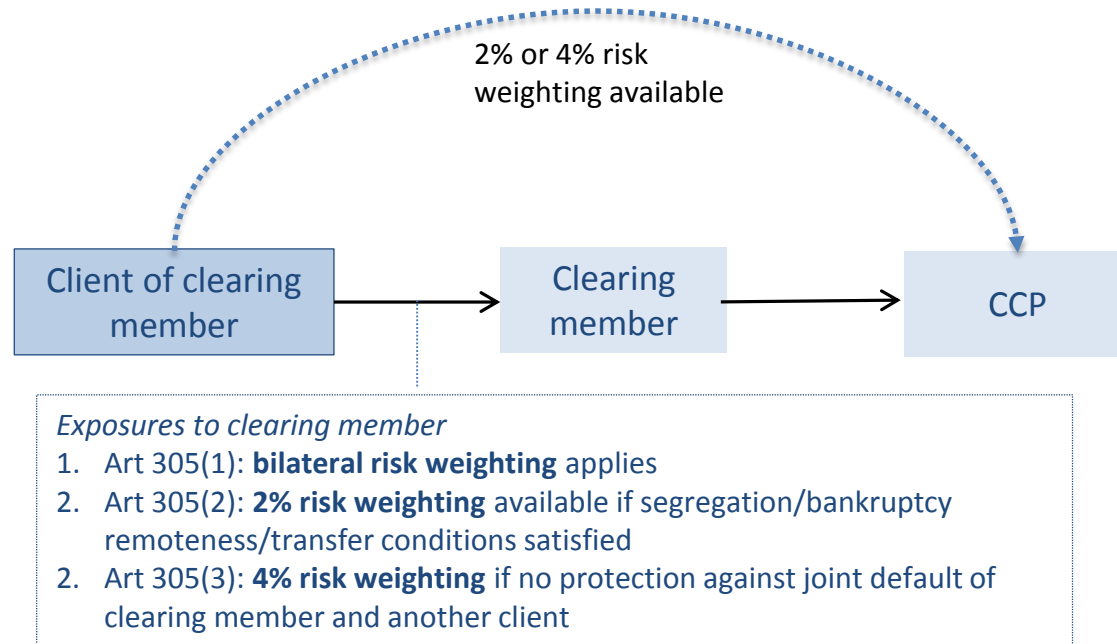
Position of client



Position of clearing member



Structure of 305 opinions



- If clearing member fails, will client “bear no losses”?
- The client may risk-weight the part of exposure covered by assets and collateral at the CCP at 2%
- Requires analysis of segregation and effects of porting/leapfrog in clearing member default
- Relevant jurisdictions for analysis are:
- Jurisdiction of CCP – laws and rules applicable to clearing member default
- Jurisdiction of CM – insolvency laws and rules applicable to treatment of client assets
- Hence two opinions – CCP and CM opinions, which need to be read together

NETTING OPINIONS

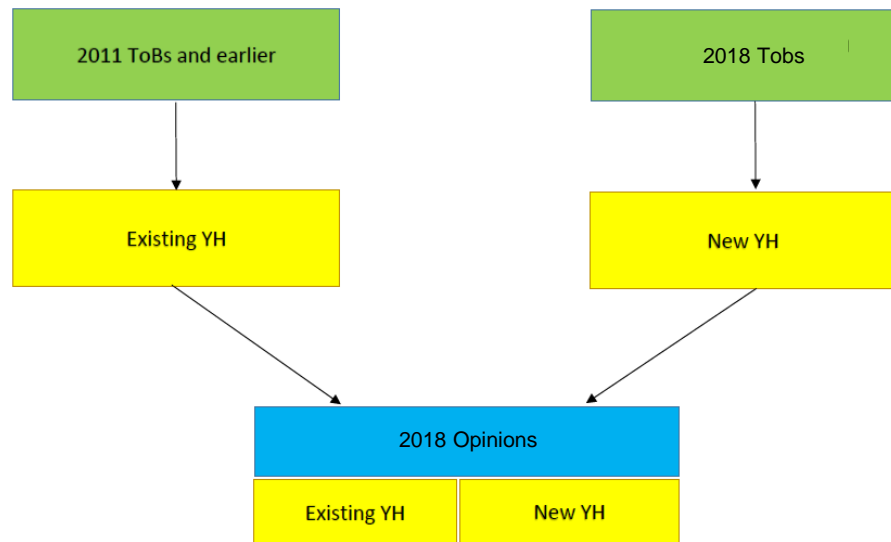
Structure of netting opinions

Central content of Netting Opinions

- Recognition of choice of law
- Core Provisions and Non-material Amendments
- Netting under standard FIA netting terms typically found in Professional Client Agreement etc
- Netting under new FIA Clearing Module and ISDA/FIA Addendum, when clearing member defaults
- Set-off clauses under all these docs
- Title transfer collateral
- NEW netting and collateral opinions cover 2018 ToBs (Core Provisions), **as well as** pre-2018 ToBs (Core Provisions)

2018 ToBs – Core Provisions

The *concept* of Core Provisions remains unchanged, however the Core Provisions themselves (**highlighted in yellow**) have been further optimised and rationalized to reflect the improved wording of certain clauses in the 2018 ToBs.



Counterparty types – netting opinions

- companies/corporations;
- banks;
- investment firms/broker dealers;
- branches in the jurisdiction of foreign banks, investment firms/broker dealers and other corporations;
- partnerships;
- insurance companies/providers;
- individuals;
- funds;
- sovereign and public sector entities;
- [parties acting as trustees of] trusts;
- charitable trusts/bodies;
- pension entities;
- building societies; and
- *additional entity types, as required.*

“Old” 4 different types of opinion

Local entities could act as Clearing Members under FOA docs (EMIR applies)

Collateral situated locally (local CCP)

Poland, Hungary

Local entities will not act as Clearing Members under FOA docs

Collateral situated locally (local CCP)

Brazil, India, Malaysia, Mexico, China, South Africa, South Korea, Taiwan, Thailand

Local entities could act as Clearing Members under FOA docs (EMIR applies)

Collateral not situated locally

Bulgaria, Croatia, Cyprus, Czech Republic, Estonia, Gibraltar, Latvia, Liechtenstein, Lithuania, Monaco, Romania, Slovenia

Local entities will not act as Clearing Members under FOA docs

Collateral not situated locally

Anguilla, Argentina, Bahrain, Barbados, Belize, Chile, Curaçao, DIFC, Egypt, Indonesia, Jordan, Kuwait, Lebanon, Macau, Mauritius, Panama, Peru, New Zealand, Slovakia

NEW netting opinion templates

Category 1 netting opinion

- Most comprehensive - previous 'Class 1'
- Firms and clients located in that jurisdiction, clearing on local or foreign CCPs, collateral located locally or elsewhere
- Concept of 'Core Provisions' clarified and simplified
- 'Two-way Margining Provisions' covered
- Opinions on various 'Set-off Provisions' simplified

Category 2 netting opinion

- Simpler template - previous 'Class 2-4'
- Client located in that jurisdiction, no local CM, no local CCP, no local collateral
- Concept of 'Core Provisions' clarified and simplified
- 'Two-way Margining Provisions' covered
- Opinions on various 'Set-off Provisions' simplified

NEW collateral opinion templates

Category 1 (situs) collateral opinion

- Always 'situs' jurisdiction
- Changes to 'Core Provisions' and coverage of 'Two-way margining provisions'
- Aim = simplified drafting process for local counsel

Category 2 (non-situs) collateral opinion

- Always 'non-situs' jurisdiction
- Changes to 'Core Provisions' and coverage of 'Two-way margining provisions'
- Aim = simplified drafting process for local counsel

Netting flag matrices

Disclaimer: Please note that this Netting Flag Matrix is a summary and cannot be relied upon by any person. The flags identified herein are subject to the assumptions, qualifications and requirement(s) to be met. A "green" box assumes that those requirements are not unusual and will have been met.

Netting Flag Matrix			
Spain			
Clifford Chance			
Situs Jurisdiction*			
	FOA netting effective?	Automatic early termination needed?	Transaction scope
Local companies	There is a risk that a court may find that the differentiation between Cleared Transaction Sets jeopardises the enforceability of the Clearing Module Netting Provision on a Party's insolvency, due to difficulties in reconciling the requirement under Spanish law for a single agreement and the fact that the Clearing Module produces separate netting sets, potentially at different times (see paragraph 3.4 of the opinion). Special wording has been recommended to mitigate this risk and state that a single agreement is created for each netting set.	Neither necessary nor recommended	All Transactions except for those referred to in paragraph (A)(v) of such Annex 2, namely, "any other Transaction which the parties agree to be a Transaction" (see paragraph 1.4 of the opinion). In order for some opinions to apply after the onset of an Insolvency Proceeding, spot trades (other than spot FX transactions) are excluded (see paragraph 4.4(c) of the opinion).
Foreign companies (local branch)	There is a risk that a court may find that the differentiation between Cleared Transaction Sets jeopardises the enforceability of the Clearing Module Netting Provision on a Party's insolvency, due to difficulties in reconciling the requirement under Spanish law for a single agreement and the fact that the Clearing Module produces separate netting sets, potentially at different times (see paragraph 3.4 of the opinion). Special wording has been recommended to mitigate this risk and state that a single agreement is created for each netting set.	Neither necessary nor recommended	All Transactions except for those referred to in paragraph (A)(v) of such Annex 2, namely, "any other Transaction which the parties agree to be a Transaction" (see paragraph 1.4 of the opinion). In order for some opinions to apply after the onset of an Insolvency Proceeding, spot trades (other than spot FX transactions) are excluded (see paragraph 4.4(c) of the opinion).

Main features of opinions

Compliant

- designed for CRR and EMIR
- very wide range of counterparties

User-friendly

- easier for document assembly
- easier to accommodate client amendments – Core Provisions and Non-material Amendments
- simple-to-use matrices

New documentation

- *****2018 FIA ToBs*** - for new opinions**
 - FIA Clearing Module (futures focus)
 - ISDA/FIA Clearing Addendum (OTC focus)
- ... as well as traditional FIA standard docs and Master Netting Agreements**

FIA Legal opinion update/governance process

- What are ‘no change confirmation letters’ (NCCLs)?
- Reviewing v. updating the opinions
- Some firms are subject to capital regimes that require them to review legal opinions on an annual basis
- FIA is aiming to migrate to an annual legal opinion review cycle which doesn’t mean that all legal opinions get updated annually
- ***New FIA Legal opinion WG to be set up in June 2018*** – *more details to follow in due course*

New FIA Legal opinion access model

- FIA plans to adopt a new documentation strategy in Europe with new subscription and pricing model;
- FIA has reviewed the current content of its documentation library in Europe and, after having polled firms last year, decided which legal opinions will form part of the new subscription model (right-sizing the library);
- The new subscription model will be a tiered membership access model which we believe is fair, transparent, cost effective and allows firms to budget for their FIA documentation expenditure in advance;
- The proposal is currently going through internal governance process and will be unveiled soon. We expect to roll it out in two stages and further communication to the existing subscribers will follow in the coming months.

Questions & Answers

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FIA

The logo consists of three letters: 'F', 'I', and 'A'. The 'F' is a solid dark grey blocky letter. The 'I' is a solid dark grey vertical bar. The 'A' is composed of several overlapping geometric shapes: a light green triangle on the left, a darker green triangle on the right, and a light blue trapezoid at the bottom. The background features a faint, light blue grid of lines and a network of thin black lines with small black dots at their intersections in the bottom right corner.