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FIA 2018 Terms of Business and FIA indirect clearing documentation

*Webinar on FIA clearing documentation and
legal opinions – Part I*

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C L I F F O R D
C H A N C E

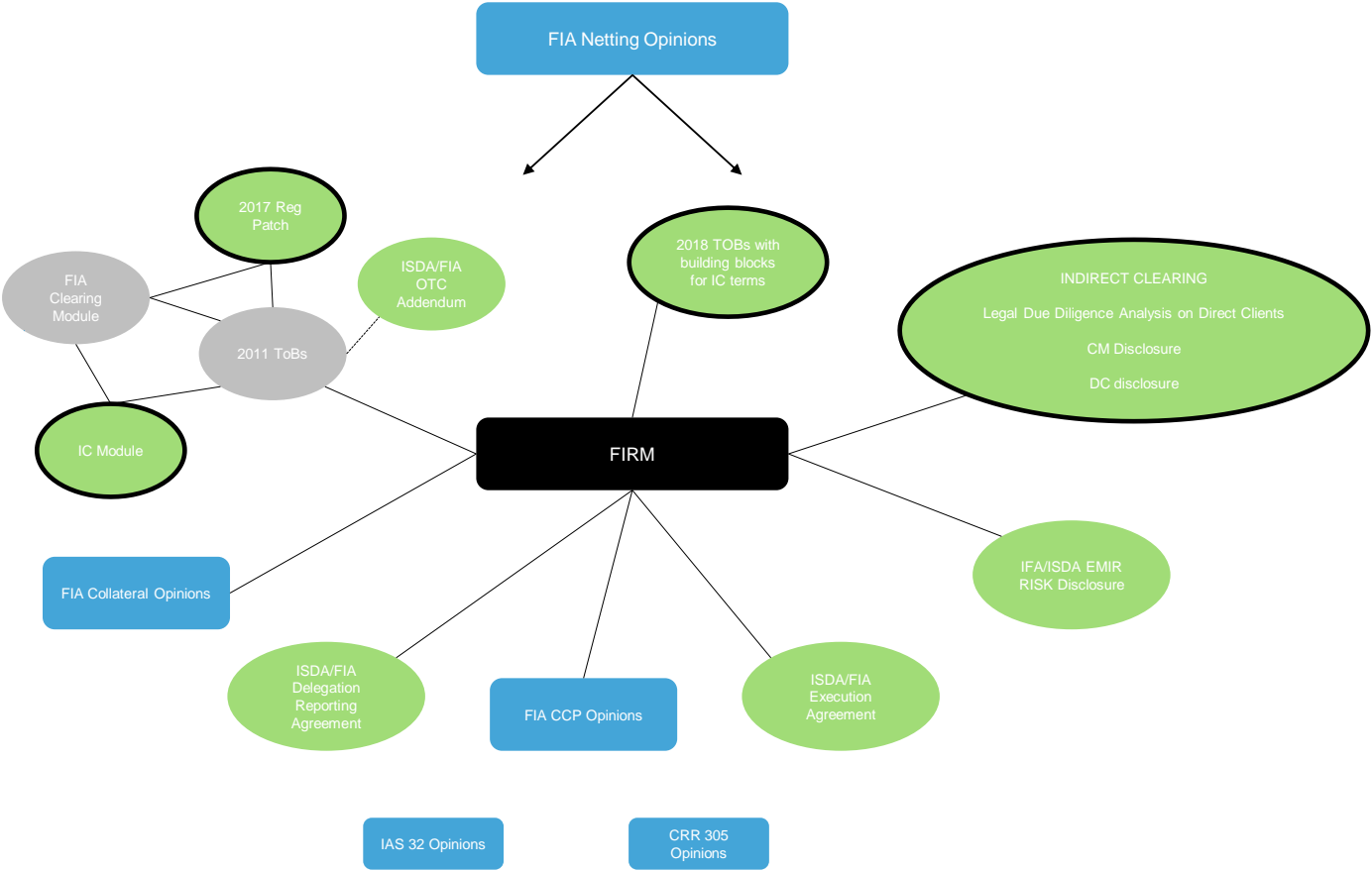


Agenda

- Introduction
- Overview of FIA Documentation
- FIA Terms of Business Update Project
- 2018 Terms of Business:
 - Scope
 - Structure
 - Core Provisions
 - Content
 - Key provisions
- FIA indirect clearing documentation
 - IC Questionnaires
 - IC Disclosures
 - IC Terms
 - IC Memos
- Scope, structure and content of FIA Indirect Clearing Terms
- FIA IC Terms – segregation and netting
- Impact of FIA Indirect Clearing Terms on FIA netting opinions
- Indirect clearing documentation for longer chains
- FAQs
- Questions

FIA 2018 Terms of Business

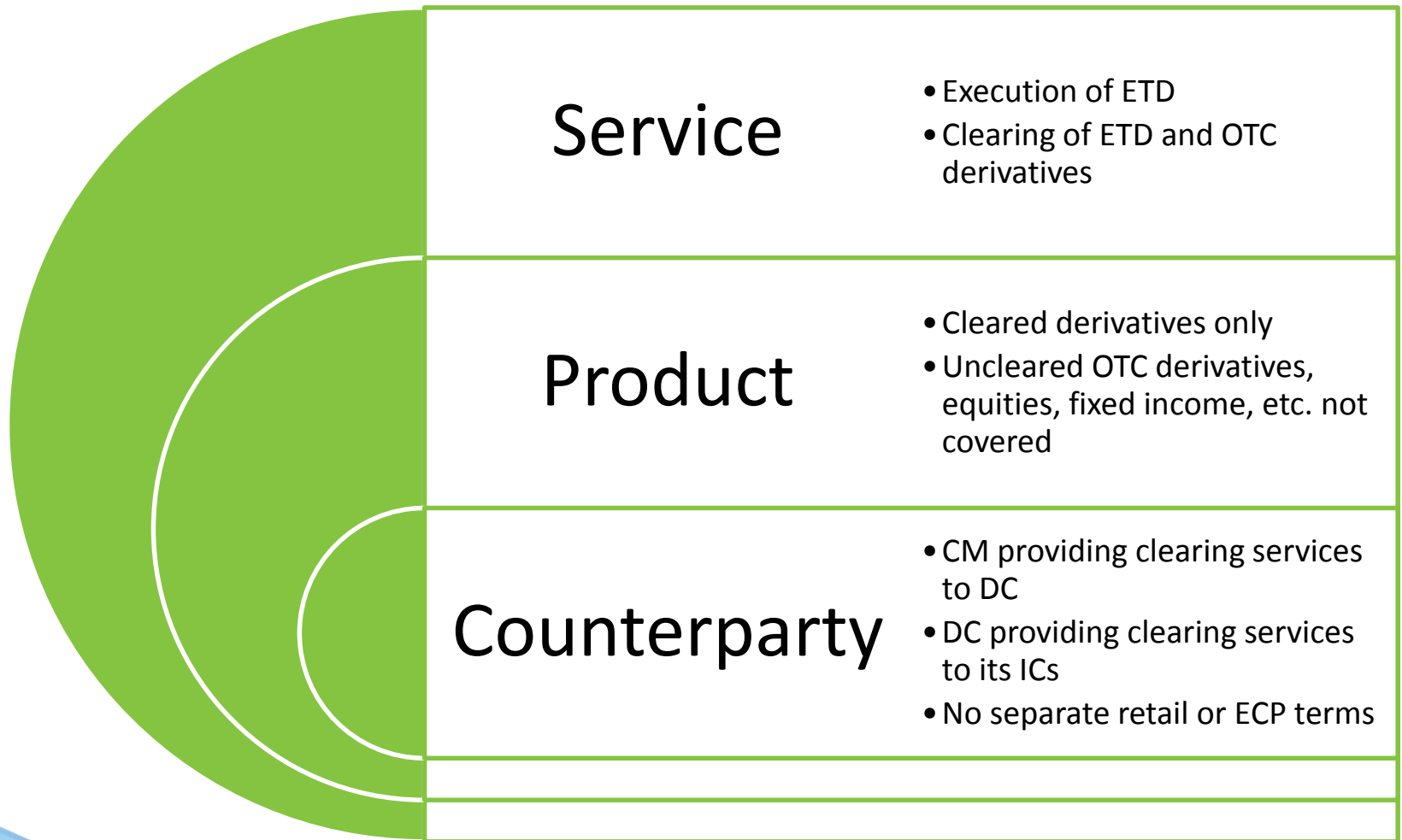
Overview of FIA Documentation (non-US)



FIA Terms of Business Update Project



2018 Terms of Business – scope



2018 Terms of Business – building blocks structure

Base Agreement

- 32 Sections – Core Provisions highlighted in yellow
- Annex
- Table A – Agreed CCPs
- Execution Schedule

Schedules and optional provisions (in User Guide)

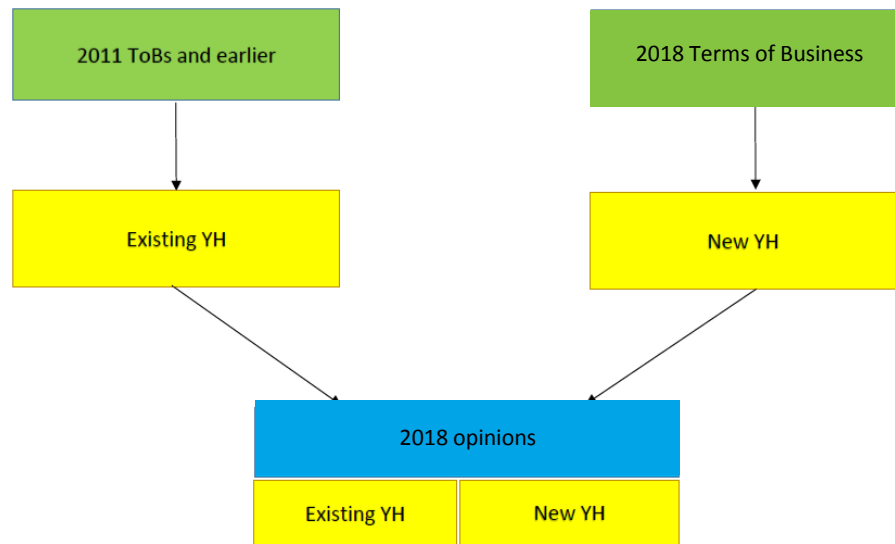
- Agency Schedule
- Trustee Schedule
- Custody Schedule
- Commodities Provisions
- Two-way Default Provisions
- Two-way Margining Module
- OTC Clearing Provisions
- General Optional Provisions

Other sections of User Guide

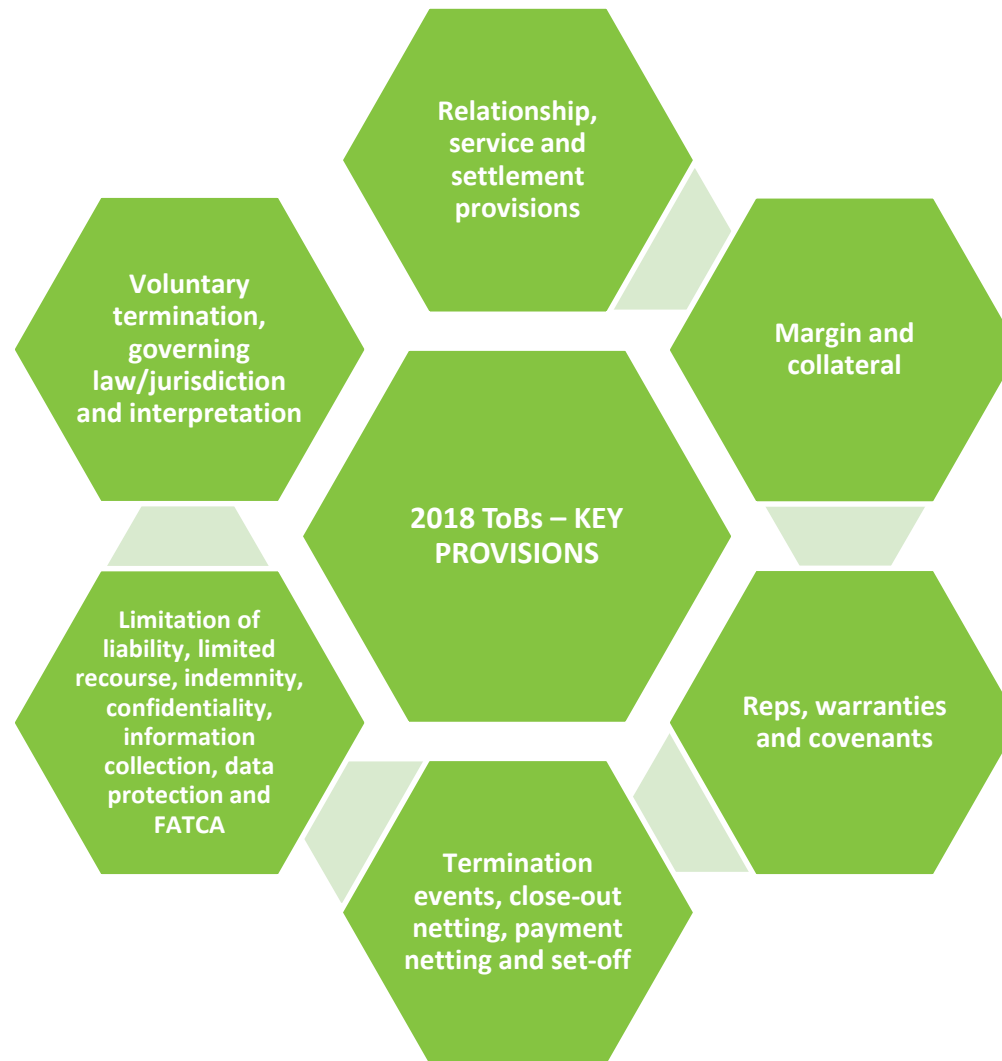
- Overview of the 2018 Terms of Business
- Clause guide to the 2018 Terms of Business
- Retail Client guidance notes

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 in the 2018 ToBs.



2018 ToBs – Key provisions of the Base Agreement



- **Relationship:**

- information about the Firm's regulatory status
- client categorisation
- subject to Applicable Regulations
- Infrastructure action

- **Services:**

- execution and clearing services – Agreed CCPs, Additional CCPs and Intermediate Clearing Broker
- separate clauses for execution and clearing
- based on assumptions about:
 - electronic services
 - no advice
- Client Money

- **Settlement provisions:**

- General physical settlement terms included

2018 ToBs – Margin and collateral

- Margin clause contains terms relating to margin calls and eligibility, but also elections where margin exchanged is collateral (title transfer or security interest)
- Title transfer and security provisions set out in separate clauses; included to be elected per Clearing Service in the Annex/Table A
- Possibility for some cash/non-cash distinctions

2018 ToBs – Termination events, close-out netting, payment netting and set-off

- Early termination events: Event of Default, Firm Trigger Event, CCP Default (latter two from the Clearing Module)
- Each a different ‘entry point’ to a single close-out netting provision
- Netting sets are “Cleared Set Termination Amounts”
- Concept of netting applying per sub-account at the CCP so can be used easily with indirect clearing supplementary terms, but nets down to a single Liquidation Amount on a Client Event of Default without the use of additional indirect clearing terms
- Note: loss/gain element included for value of terminated Transaction instead of simply relying on, e.g. CCP value
- Possibility of Firm determining or Client determining on Firm Trigger Event

- Voluntary termination of Clearing Service or Agreement
- No automatic termination of Transactions
- Firm has active management powers and as an alternative to allowing Transactions to run to their maturity, it can, for instance:
 - Close-out Transactions
 - Sell investments
 - Arrange for the porting of Transactions

2018 Terms of Business– FAQs

1

- **Can I use the 2018 ToBs when providing clearing services to a client in the CM capacity on one CCP and, for the same client, via a third-party clearing member to another CCP?**
- Yes, the 2018 ToBs have been designed to work between the clearing member and its clients, as well as between the client and its indirect clients. It will be down to each firm to decide whether they wish to structure their contractual arrangement with the client such that they enter into two separate agreements (depending on whether they provide service as the CM or the DC), or whether they will make appropriate changes to use a single agreement.

2

- **Does the new agreement cater for TTCA to apply to some collateral and security interest to apply to other collateral?**
- Yes, the 2018 ToBs allow for such flexibility so firms are no longer restricted to only choosing one method of taking collateral from one client.

3

- **Can US FCMs use the 2018 ToBs and can they be governed by NY law?**
- FIA 2018 ToBs have been drafted with the principal-to-principal clearing model in mind and are therefore not meant to be used by US FCMs. The 2018 ToBs are governed by English law and subject to English courts/arbitration, however firms are free to choose a different governing law or amend the jurisdiction clause. However, firms should note that FIA netting and collateral opinions are based on the assumption that the underlying clearing documentation is governed by English law.

4

- **The 2011 PCA included useful endnotes. Why do they not feature in the 2018 ToBs?**
- It has been decided that commentary and explanation of the regulatory background to most of the 2018 ToBs provisions be enhanced and moved in a separate, more comprehensive document – the User Guide.

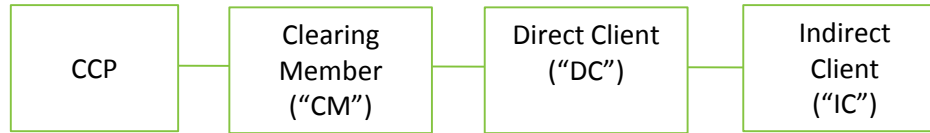
5

- **How can I document my indirect clearing arrangements to comply with the MiFIR indirect clearing requirements?**
- FIA has published a number of industry standard documents, including the indirect clearing terms, to help firms meet the indirect clearing requirements. These can be used in conjunction with the 2018 Terms of Business or the existing PCA 2011.

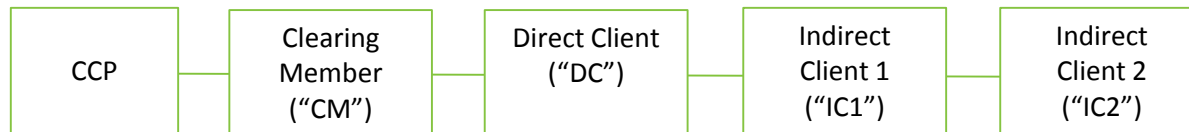
FIA indirect clearing documentation

Indirect clearing chains

Four party chain



Longer chain combinations



- The MiFIR and EMIR Indirect Clearing RTS set out the conditions under which indirect clearing services can be provided.
- There are additional restrictions on longer chains – more detail is set out in the longer chains memorandum. The Indirect Clearing RTS prohibit longer chains which extend past IC3.

FIA indirect clearing documentation (*non-US*)

Documentation type	Pre-2018 Terms of Business				2018 Terms of Business	
Client clearing arrangements	2011 PCA with Clearing Module		2011 PCA without Clearing Module		2018 Terms of Business	
Clearing level	CM-DC	DC-IC	CM-DC	DC-IC	CM-DC	DC-IC
Indirect clearing arrangements – contractual terms	CM-DC BOSA only Terms	DC-IC BOSA only Terms*	N/A	DC-IC BOSA only Terms*	CM-DC BOSA only Terms	DC-IC BOSA only Terms
	CM-DC BOSA/GOSA Terms	DC-IC BOSA/GOSA Terms*		DC-IC BOSA/GOSA Terms*	CM-DC BOSA/GOSA Terms	DC-IC BOSA/GOSA Terms
Indirect clearing arrangements – non-contractual documentation	Indirect clearing jurisdictional legal due diligence	/	Indirect clearing jurisdictional legal due diligence	/	Indirect clearing jurisdictional legal due diligence	/
	CM risk disclosure	/	CM risk disclosure	/	CM risk disclosure	/
	/	DC risk disclosure	/	DC risk disclosure	/	DC risk disclosure

* There are two sets of indirect clearing terms that can be used to supplement a contractual relationship between the DC and IC based on the PCA 2011: the DC-IC BOSA only Terms and the DC-IC BOSA/GOSA Terms. Each can be used regardless of whether or not a Clearing Module has been entered into between the DC and IC.

List of all FIA indirect clearing documents

IC jurisdictional questionnaires

England & Wales, France, Germany, Switzerland, the US, Australia, Denmark, the Netherlands, Austria, Luxembourg, Singapore, Spain, Hong Kong, Italy, Sweden, Greece, Belgium, Canada (Ontario), Guernsey, Israel, South Korea, Poland

- The purpose of the indirect clearing questionnaire is to ascertain how laws of the direct client's jurisdiction treat certain indirect clearing requirements (e.g. segregation, porting, leapfrog) and whether they give them legal effect pre- and post-direct client's insolvency, either by way of statutory protections or otherwise (e.g. private contractual interest arrangements). The indirect clearing questionnaires are jurisdiction specific and inform clearing members as to whether the MiFIR RTS default management requirements are legally effective in a specific client jurisdiction and what they or their clients may need to do to make them legally effective.

Clearing member IC risk disclosure

England & Wales, France, Germany, Switzerland and the US

- This document outlines risks for indirect clients in the event of the clearing member's default, depending on the level of segregation they choose. These disclosures are specific to the clearing member's jurisdiction and build on the existing FIA/ISDA EMIR Article 39(7) risk disclosure.

Direct client IC risk disclosure

England & Wales, France, Germany, Switzerland, the US, Australia, Hong Kong, Singapore and Canada (Ontario)

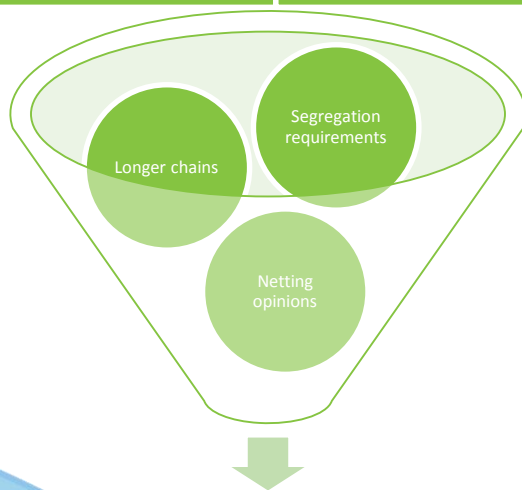
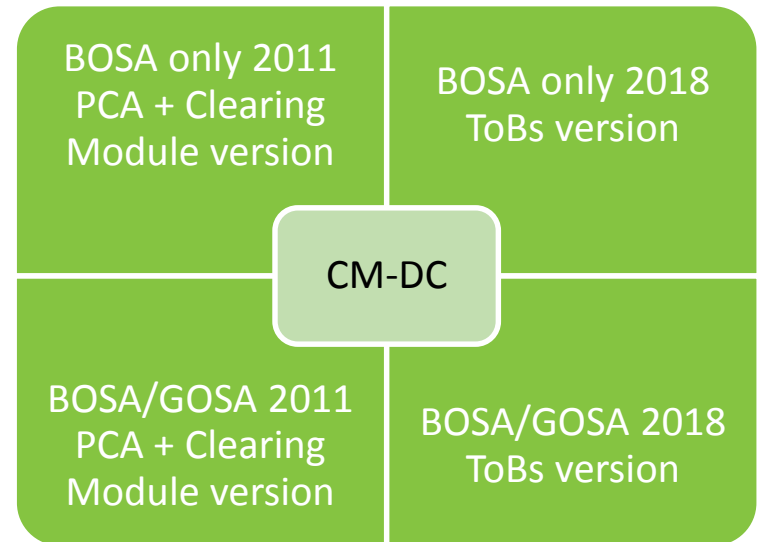
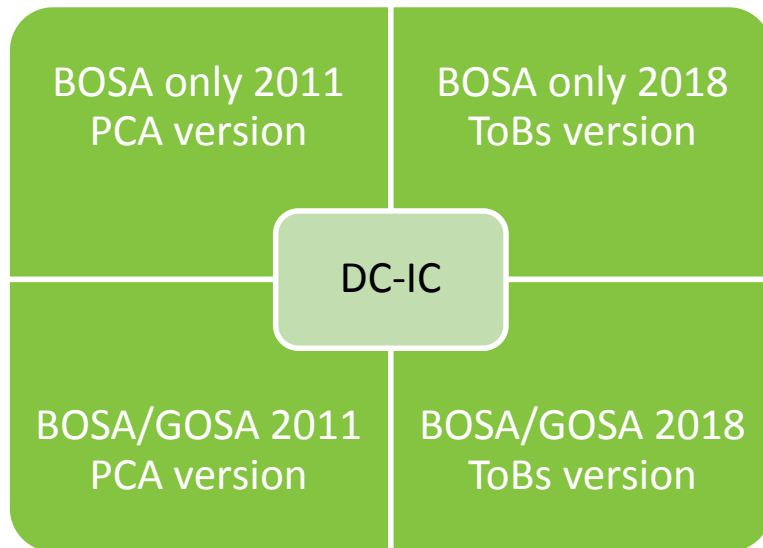
- This document outlines risks for indirect clients in the event of the direct client's default, depending on the level of segregation they choose. These disclosures are specific to the direct client's jurisdiction and are similar in structure to the existing FIA/ISDA EMIR Article 39(7) risk disclosure.

Indirect clearing terms

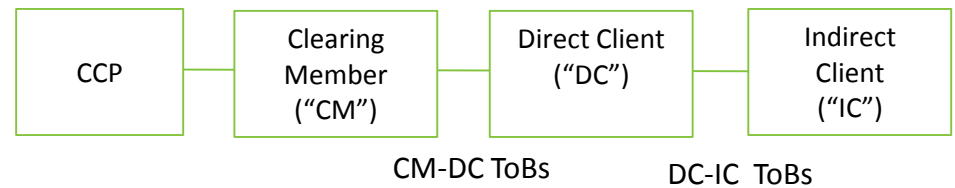
FIA Indirect clearing terms are compatible with the Pre-2018 Terms of Business, as well as the newly launched 2018 Terms of Business.

- Clearing member – direct client: Terms for use with BOSAs and GOSAs; Basic OSA only Terms
Direct client – indirect client: Terms for use with BOSAs and GOSAs; Basic OSA only Terms

FIA Indirect Clearing Terms

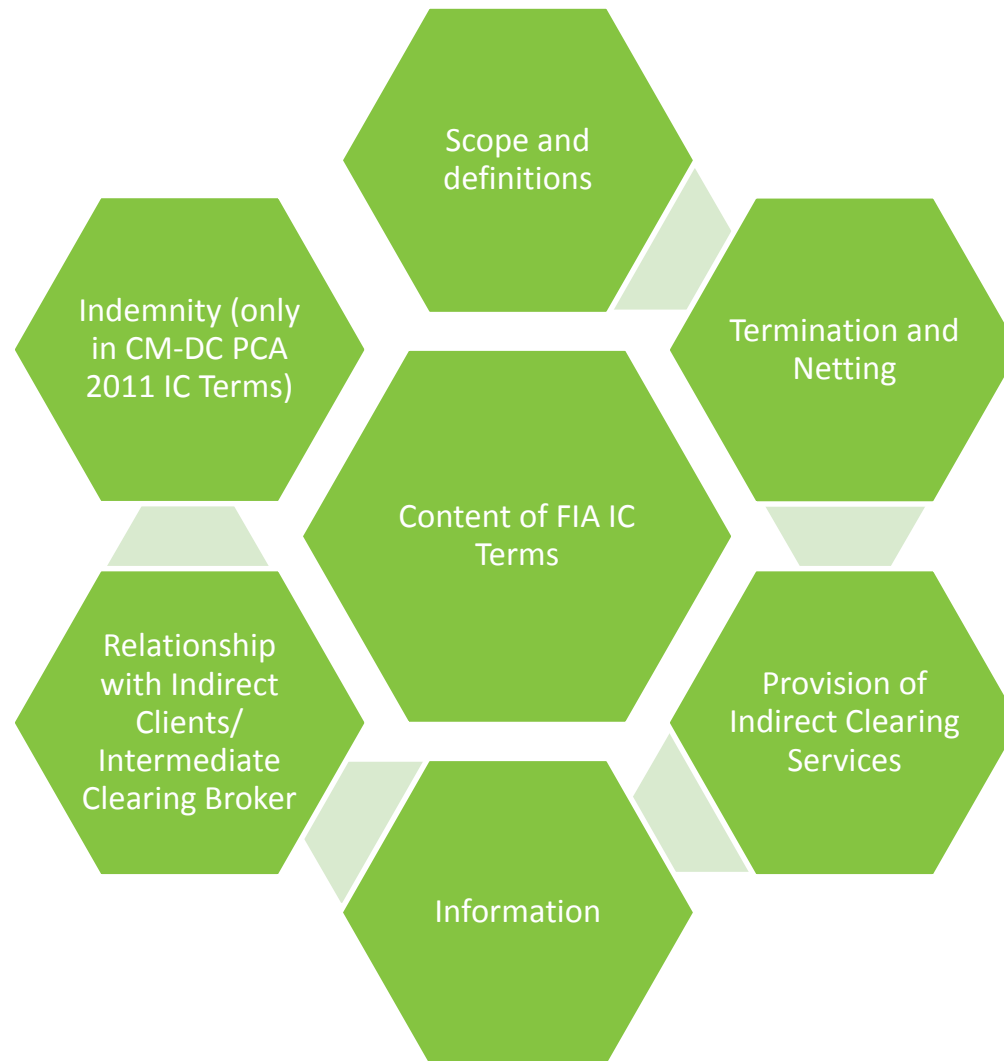


Indirect clearing memos

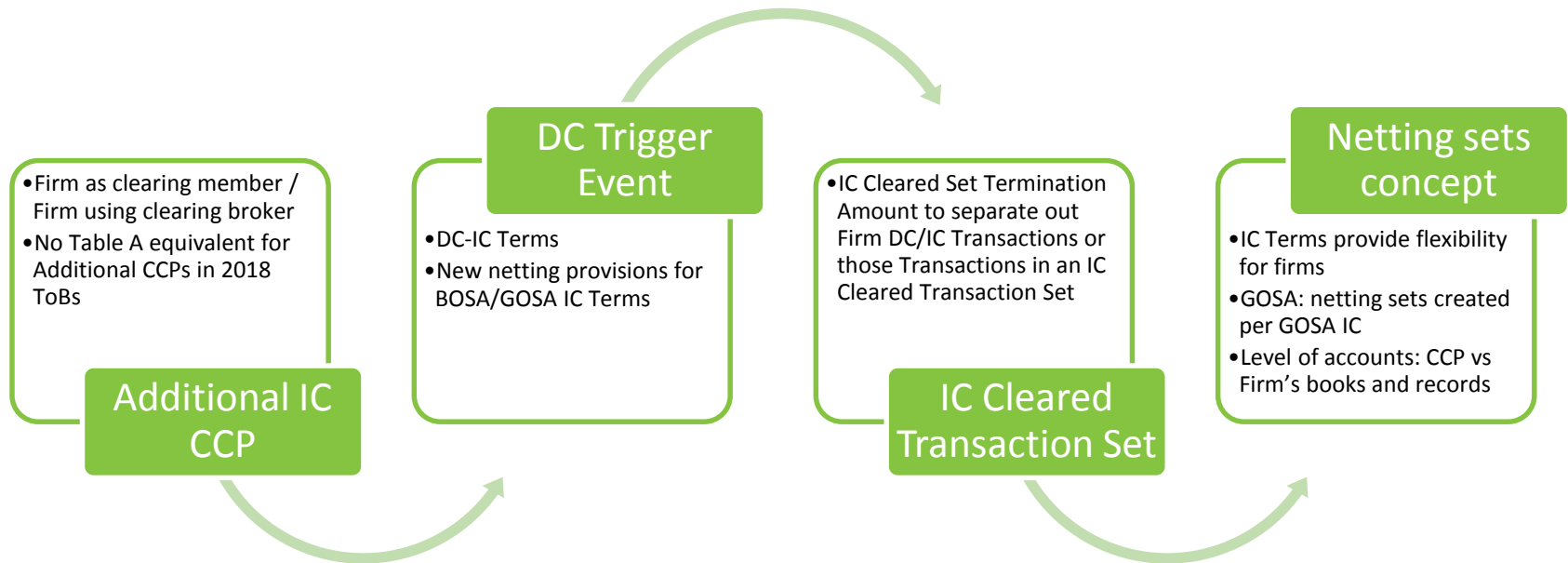


- ***A Firm could act as CM and DC under the same Terms of Business.***
- ***The IC terms can be used with ETD and OTC.***

FIA Indirect Clearing Terms - content



FIA Indirect Clearing Terms – segregation and netting



The Indirect Clearing RTS do not expressly require parties to create separate Netting Sets or Termination Amounts and there is some uncertainty as to what the requirements are. However, those terms have been included to satisfy the requirements of the Indirect Clearing RTS and we believe they provide the parties with a significantly greater level of legal certainty.

FIA Indirect Clearing Terms – impact on FIA netting opinions

Why are FIA top-up netting opinions required?

- CM-DC level:
 - Creation of multiple Liquidation Amounts/Cleared Set Termination Amounts instead of a single net Liquidation Amount/Cleared Set Termination Amount (as the case may be)
 - Amended Core Provisions
- DC-IC level:
 - New termination event ('DC Trigger Event')
 - New Core Provisions

Indirect clearing documentation for longer chains

- Permissible longer chains – requirements and examples
- How can FIA existing indirect clearing documentation be modified for use in the context of longer chains?
 - 5-entity IC chains: Integrity of netting sets relating to IC2 must be preserved between DC and IC1
 - 6-entity IC chains: Integrity of netting sets relating to IC3 must be preserved between IC1 and IC2
 - Contractual terms between DC-IC1 (5-entity IC chains) or IC1-IC2 (6-entity IC chains):
 - To achieve the objectives above, modified CM-DC IC Provisions (BOSA only) (either PCA 2011 or 2018 ToBs) can be used when IC1 has elected a BOSA; or
 - Modified CM-DC IC Provisions (BOSA/GOSA) (either PCA 2011 or 2018 ToBs) can be used when IC1 has elected a GOSA.
 - Contractual terms IC1-IC2 (5-entity IC chains) or IC2-IC3 (6-entity IC chains):
 - Modified DC-IC IC Terms (BOSA only) (either PCA 2011 or 2018 ToBs) can be used.

Firms will need to remove and/or amend the provisions in any supplementary indirect clearing terms prepared for use between the clearing member and direct client which prohibit longer chains), and adjust terminology.

FIA indirect clearing documentation– FAQs

1

•How can I access FIA indirect clearing documentation?

- We host all our indirect clearing documents on the [FIA Documentation Platform](#). Members and non-members are welcome to access our documentation. Some documents are available to firms free of charge, whereas others are available for a fee. The list of all FIA indirect clearing documents with subscription fees (where applicable) is available [here](#).

2

•Does FIA plan to publish an industry standard security interest arrangement for indirect clearing?

- No, FIA currently doesn't envisage creating an industry standard security interest arrangement to meet the IC RTS GOSA requirements, as the guidance received from regulators suggests that the way we have designed our IC Terms is sufficient to meet the IC RTS GOSA requirements.

3

•How does FIA indirect clearing documentation cover the 'Lockbox' requirement?

- We have included a general provision in the GOSA CM-DC IC Terms relating to the provision of information required by the Firm on default (paragraph 4.3) and paragraph 4.4 requires that Clients establish procedures which are satisfactory to the Firm to contemplate that eventuality. For GOSA ICs, that mechanism must include the identity of indirect clients. We anticipate that the Firm and Client will enter into a locked box or other "break glass" mechanism, which will facilitate the transfer of that information in the event of a default of the DC.

4

•How much netting and set-off is allowed under the MiFIR indirect clearing rules and FIA indirect clearing documentation?

- Separate Liquidation Amounts/IC Cleared Set Termination Amounts are created to separate out Firm DC/IC Transactions or those Transactions in an IC Cleared Transaction Set. Some firms wish to have the ability to further net amounts by, for instance, netting a Liquidation Amount which would otherwise be owed by the CM to the DC relating to DC proprietary positions against a separate Liquidation Amount which would otherwise be owed by the DC to the CM relating to indirect clearing positions.

5

•What is the value-added of the BOSA DC-IC Terms?

- The DC-IC (BOSA only) indirect clearing terms are principally intended to require the IC's consent to disclosure of information down the clearing chain to facilitate compliance with the Indirect Clearing RTS. Other benefits of putting the BOSA DC-IC Terms in place include: (i) the DC ensures that the IC does not offer related indirect clearing services without the DC's consent, (ii) the IC acknowledges that further documentation or other requirements may apply if the IC wishes to switch its account type (e.g. to a GOSA) and (iii) there is optional language in clause 4 for the IC to acknowledge that the CM may communicate with the IC in the event of a default of the DC.

Questions & Answers

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C L I F F O R D
C H A N C E



FIA

The logo consists of three characters: 'F', 'I', and 'A'. The 'F' is a solid dark grey block letter. The 'I' is a solid dark grey block letter. 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 triangle on the right. A horizontal blue bar overlaps the bottom of the 'A'.