

July 2014

*FIA Europe obtains CRR
Article 305(2)(c) opinions*

FIA Europe legal opinions under CRR Article 305(2)(c)

*LCH.Clearnet Limited and English
clearing members*



EXECUTIVE SUMMARY

Provided that clients of clearing members agree with assumptions and interpretation of CRR Article 305(2) which are explained in the FIA Europe 305(2)(c) “look-through” opinions, they can benefit from a 2% risk weight for trade exposures to the CCP.



FIA Europe 305 opinions only apply to prudentially regulated clients who are required to comply with CRDIV/CRR and who clear contracts on LCH.Clearnet Limited through an English clearing member

Clients must elect an individually segregated account (ISA) as defined in EMIR in order to benefit from these opinions

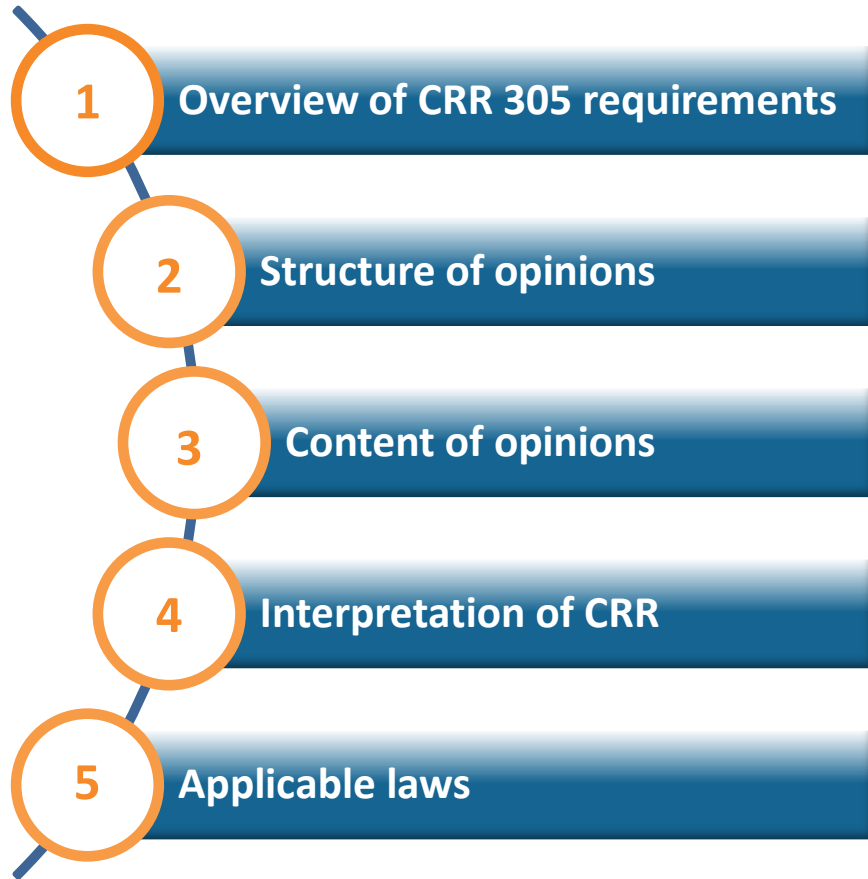
FIA Europe 305 “look-through” opinions are client documentation agnostic

FIA Europe 305 “look-through” opinions help clients to reduce their risk weight, but they say nothing about the exposure value

If a client doesn't have an ISA, it doesn't automatically qualify for a 4% risk weight and the opinions do not include any analysis on the 4% risk weight requirements

FIA Europe is considering to expand a number of CCPs and CM jurisdictions covered by these opinions. We are also exploring a possibility to obtain a legal opinion to satisfy 4% risk weight requirements

AGENDA



CRR 305(2) requirements

Clients of clearing members shall apply a bilateral risk weight for their exposures to the CM in relation to the CCP-related transactions, unless certain conditions in CRR Article 305(2) are met which then make a risk-weighting of 2% or 4% potentially available.

the positions and assets of that institution related to those transactions are distinguished and segregated, at the level of both the clearing member and the CCP, from the positions and assets of both the clearing member and the other clients of that clearing member and as a result of that distinction and segregation those positions and assets are bankruptcy remote in the event of the default or insolvency of the clearing member or one or more of its other clients;

laws, regulations, rules and contractual arrangements applicable to or binding that institution or the CCP facilitate the transfer of the client's positions relating to those contracts and transactions and of the corresponding collateral to another clearing member within the applicable margin period of risk in the event of default or insolvency of the original clearing member. In such circumstance, the client's positions and the collateral shall be transferred at market value unless the client requests to close out the position at market value;

the institution has available an independent, written and reasoned legal opinion that concludes that, in the event of legal challenge, the relevant courts and administrative authorities would find that the client would bear no losses on account of the insolvency of its clearing member or of any of its clearing member's clients under the laws of the jurisdiction of the institution, its clearing member and the CCP, the law governing the transactions and contracts the institution clears through the CCP, the law governing the collateral, and the law governing any contract or agreement necessary to meet the condition in point (b)

the CCP is a QCCP

FIA Europe approach

We have split a legal opinion requirement in Article 305(2)(c) into two separate but complementary legal opinions to enable more QCCPs and more clearing member types to be covered over time.

The following is covered in the 305 CCP opinion under the law applicable to the CCP:

the segregation of the positions and assets of the client from the positions and assets of the clearing member and of other clients is legally effective; and in particular so that, in the event of default or insolvency of the clearing member or other clients, the client's assets will not be available to cover losses of the clearing member or other clients following the default of the clearing member or one or more of its other clients (ie they will be "bankruptcy remote").

there are arrangements for the transfer of the client's positions and collateral to another clearing member which are legally effective; and that no rules of law would prevent or delay the implementation of such arrangements in the event of default or insolvency of the original clearing member.

as a consequence of the foregoing, the client would "bear no losses" on account of the insolvency of the clearing member or its other clients.

The following is covered in the CM 305 opinion under the law applicable to the clearing member:

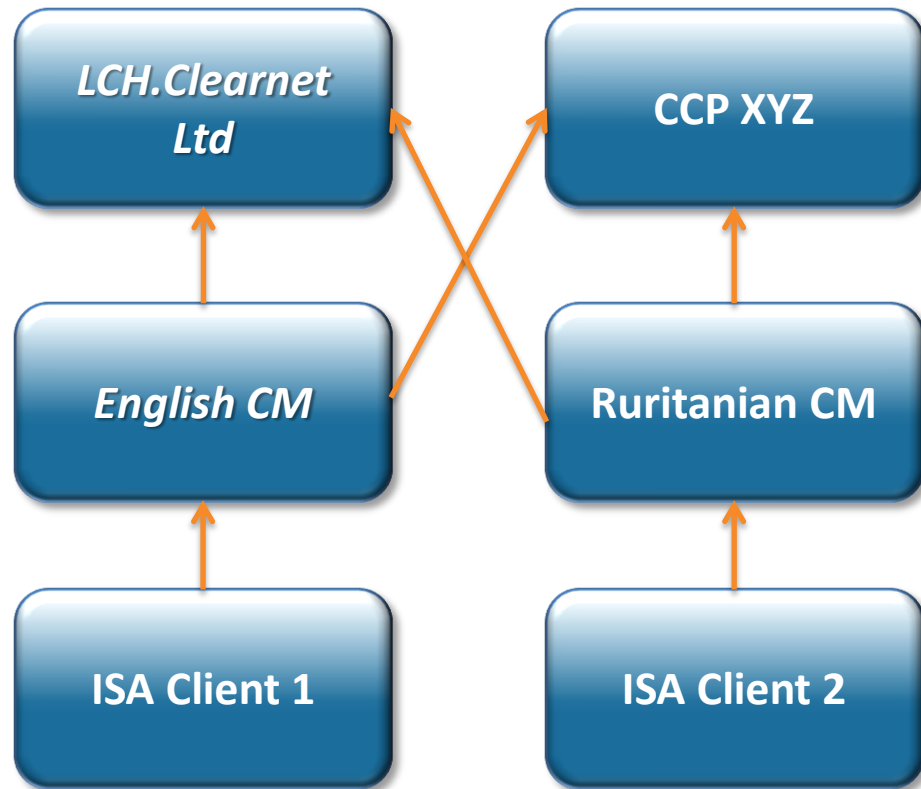
the segregation of the positions and assets of the client from the positions and assets of the clearing member and of other clients is legally effective; and in particular so that, in the event of default or insolvency of the clearing member or other clients, the client's assets will not be available to cover losses of the clearing member or other clients following the default of the clearing member or one or more of its other clients (ie they will be "bankruptcy remote").

there are no rules of law to prevent or delay the implementation of the CCP's arrangements for the transfer of the client's positions and collateral to another clearing member in the event of default or insolvency of the original clearing member.

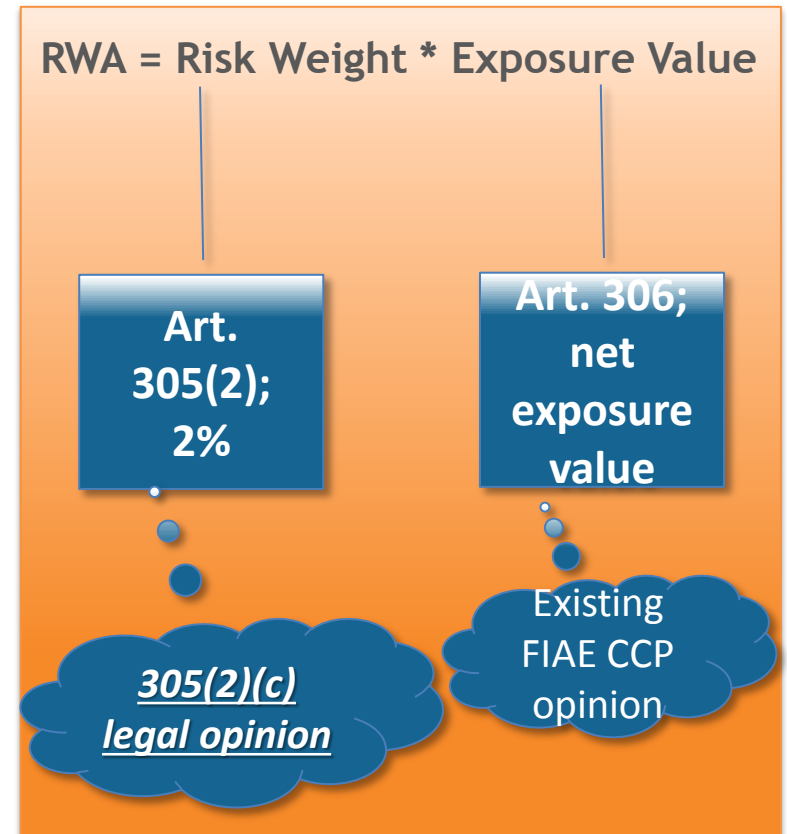
as a consequence of the foregoing, the client would "bear no losses" on account of the insolvency of the clearing member or its other clients.

STRUCTURE OF THE OPINIONS

Structure of the opinions enables us to expand the list of CCPs and CM jurisdictions.



Structure of the opinions enables us to expand the list of CCPs and CM



CONTENT

The layout of the CCP and CM 305 opinions is as follows



Introduction and orientation

- Terms of reference (*CCP & CM opinions*)
- Relevance of the laws of other jurisdictions (*CCP & CM opinions*)
- Material assumptions (*CCP & CM opinions*)
- Insolvency procedures applicable to the Clearing Member (*CM opinion only*)
- Description of clearing under the Rules of the CCP (*CCP opinion only*)
- Description of default management processes under the Rules of the CCP (*CCP opinion only*)
- Effect of insolvency laws in default scenario (*CCP & CM opinions*)

Analysis of protection given to Client

- Segregation and bankruptcy remoteness of Client positions and assets (*CCP & CM opinions*)
- Transfer of Client positions and assets to replacement Clearing Member (*CCP & CM opinions*)
- Close out of positions (*CCP & CM opinions*)

Conclusions

- Conclusions as to whether Client would "bear no losses" (*CCP & CM opinions*).

INTERPRETATION OF CRR

"bankruptcy remote" is defined in article 300(1) of the CRR

We understand that in the context of article 305 of the CRR it is not necessary to consider the effect of the insolvency or reorganisation measures in respect of the CCP.

"bear no losses" is not defined in the CRR

We understand that the phrase means that in the event of the insolvency of the Clearing Member or one of its other clients, the Client's positions and assets at the Clearing Member level would neither be diminished nor rendered unenforceable as a result of the insolvency of the Clearing Member or its other clients.

"segregated" is not defined in the CRR

For the purposes of these opinions, we understand that "segregated" has the meaning given to "individual client segregation" as explicated in article 39(4) of EMIR (and, so far as is relevant, article 39(9) of EMIR), which requires that the assets and positions held for the account of a client be distinguished from those held for the account of the relevant Clearing Member and its other clients. These requirements reflect those for "individual client segregation" at the CCP level as explicated in article 39(3) of EMIR.

APPLICABLE LAWS

Article 305(2)(c) of the CRR identifies which laws are considered to be relevant for the purposes of an analysis of whether a client would "bear no losses" in the context of a particular client clearing arrangement.

CCP opinion:

- the law applicable to the jurisdiction of the CCP
- the law governing the arrangements for a transfer of the Client's positions and assets in the event of default of a Clearing Member
- The law governing Contracts cleared at the CCP
- The law governing the Client's collateral at the CCP. We understand that, for the purposes of the CRR, the law governing the collateral means the law applicable to the Client's entitlement to the collateral.

CM opinion:

- The law applicable to the jurisdiction of the CM
- The law governing the Client's collateral as provided to the CM

Conflict of laws issues:

Under the conflict of laws rules of E&W, it would make no difference to the conclusions in these opinions if the Client or a person other than the Client, under the law governing the CCP-related transactions or the law applicable to the jurisdiction of the Client, asserted a claim to the Client's positions and assets at the CCP or CM level or to challenge the manner in which any of them may be dealt with by the CCP or in the event of default of the CM or another client. The laws of E&W would not recognise or give effect to any law applicable to the Client which purported to interfere with the Client's rights against the CM or the CCP.

SCOPE

The CCP 305 opinion does not address any matters which may be relevant and which arise under the law applicable to the jurisdiction of the CM. The CM 305 opinion is “CCP-agnostic” and doesn’t cover any issue which arise under the law applicable to the jurisdiction of the CCP.

Clients

For the purposes of these opinions, a "Client" is a "client" as defined in article 300(4) of CRR who has entered into an arrangement with a Clearing Member for the clearing of transactions entered into by or on behalf of the Client.

Transactions

The English CM 305 opinion applies in respect of the Client's CCP-related transactions. It is not limited in respect of the types of contract cleared at the CCP, except that it does not cover any contracts cleared at the CCP which are not of a type referred to in article 301(1) of the CRR or any clearing service provided by the CCP which (a) operates on the basis of the Clearing Member acting for any purpose as agent, or (b) involves interoperability between the CCP and another central counterparty. The LCH.Clearnet Ltd 305 opinion covers all contracts cleared at the CCP, except for FCM contracts and Co-operating Clearing House Contracts (interoperability arrangements).

Account structures

The opinions only apply where the Client has elected for "individual client segregation" for the purposes of article 39(3) of EMIR in relation to its contracts cleared at the CCP.

SCOPE - cont'd

CM entities

This Memorandum applies in respect of a Clearing Member who carries out the role defined in article 300(2) of the CRR, and which is:

- a person incorporated in England and Wales under the Companies Acts which has permission to accept deposits by virtue of Part 4A of FSMA (an "English Bank");
- a person incorporated in England and Wales under the Companies Acts (whether or not an English Bank) which qualifies under section 232 of the Banking Act 2009 as an "investment bank" (an "English Investment Bank");
- a branch in England and Wales of a bank incorporated or organised in an EEA member state other than the United Kingdom (an "EEA Bank");
- a branch in England and Wales of an investment firm incorporated or organised in an EEA member state other than the United Kingdom (an "EEA Investment Firm"); or
- a branch in England and Wales of a bank incorporated or organised in a country or territory outside the EEA (a "Third Country Bank").

In relation to a Clearing Member which is an EEA Bank, an EEA Investment Firm, or a Third Country Bank, the CM 305 opinion:

- applies only in relation to clearing services provided in this jurisdiction in relation to a CCP incorporated in this jurisdiction;
- is limited to the analysis of cash or securities credited to a securities account, provided on the books of the CCP or the Clearing Member as the case may be, located in this jurisdiction.

SCOPE - cont'd

Collateral – CM 305 opinion

The CM 305 opinion also applies in respect of collateral which comprises either cash provided in a currency that is freely transferable internationally under the laws of all relevant jurisdictions or freely transferable securities in book-entry form, which has been provided in respect of the Client's CCP-related transactions:

- on a title-transfer basis to the Clearing Member, or under a security interest in circumstances where the Clearing Member has exercised an unconditional right of use; or
- to the CCP as Security Interest Collateral.

NB: CCPs may be entitled to accept gold as eligible collateral under EMIR. Gold is not within the scope of this opinion.

Collateral – CCP 305 opinion

The CCP 305 opinion applies in respect of the Client's positions and assets at the level of the CCP as evidenced by credits and debits to an Account provided on the books of the CCP which is located in this jurisdiction, including such assets relating to collateral originally provided by the Client to the Clearing Member in respect of its CCP-related transactions comprising either

- cash provided in a currency that is freely transferable internationally under the laws of all relevant jurisdictions or
- freely transferable securities in book-entry form, provided on a title-transfer basis to the Clearing Member, or under a security interest in circumstances where the Clearing Member has exercised an unconditional right of use.

MATERIAL ASSUMPTIONS

Counsel have made various assumptions in order to give the opinions on a generic basis, including:

that the CCP has been authorised by the competent authority for the purposes of article 14 of EMIR, designated for the purposes of Directive 98/26/EC (the Settlement Finality Directive)

that all dealings between the CCP and the Clearing Member, and between the Clearing Member and the Client, are on a principal-to-principal basis.

that the Clearing Member has duly established an Account for the Client at the CCP in conformity with, and has complied with its other obligations under, article 39 of EMIR.

as to the content and validity of the clearing agreement in place between client and clearing member and other documentation

that the collateral provided by the client comprises only cash and securities collateral credited to accounts in the jurisdiction of the CCP

that the clearing agreement between the client and clearing member, the operational arrangements and accounting treatment are consistent with the relevant segregation requirements

that the transactions cleared are governed by the laws of the jurisdiction of the CCP and/or the clearing member.

RELIANCE

Clients purchasing the opinions may use these opinions for regulatory capital purposes only (=regulatory reliance).

reliance (use) ≠ reliance (sue)

Can a client who purchased the opinions show them to its regulator(s) or auditor(s)?

- YES, the FIA Europe 305 opinions have been obtained for exactly this purpose.
- negligence liability ≠ regulatory reliability

IMPORTANT: FIA Europe 305 opinions can only be shown to persons listed under a) to c) in the reliance language on the right hand side of this slide

Reliance language:

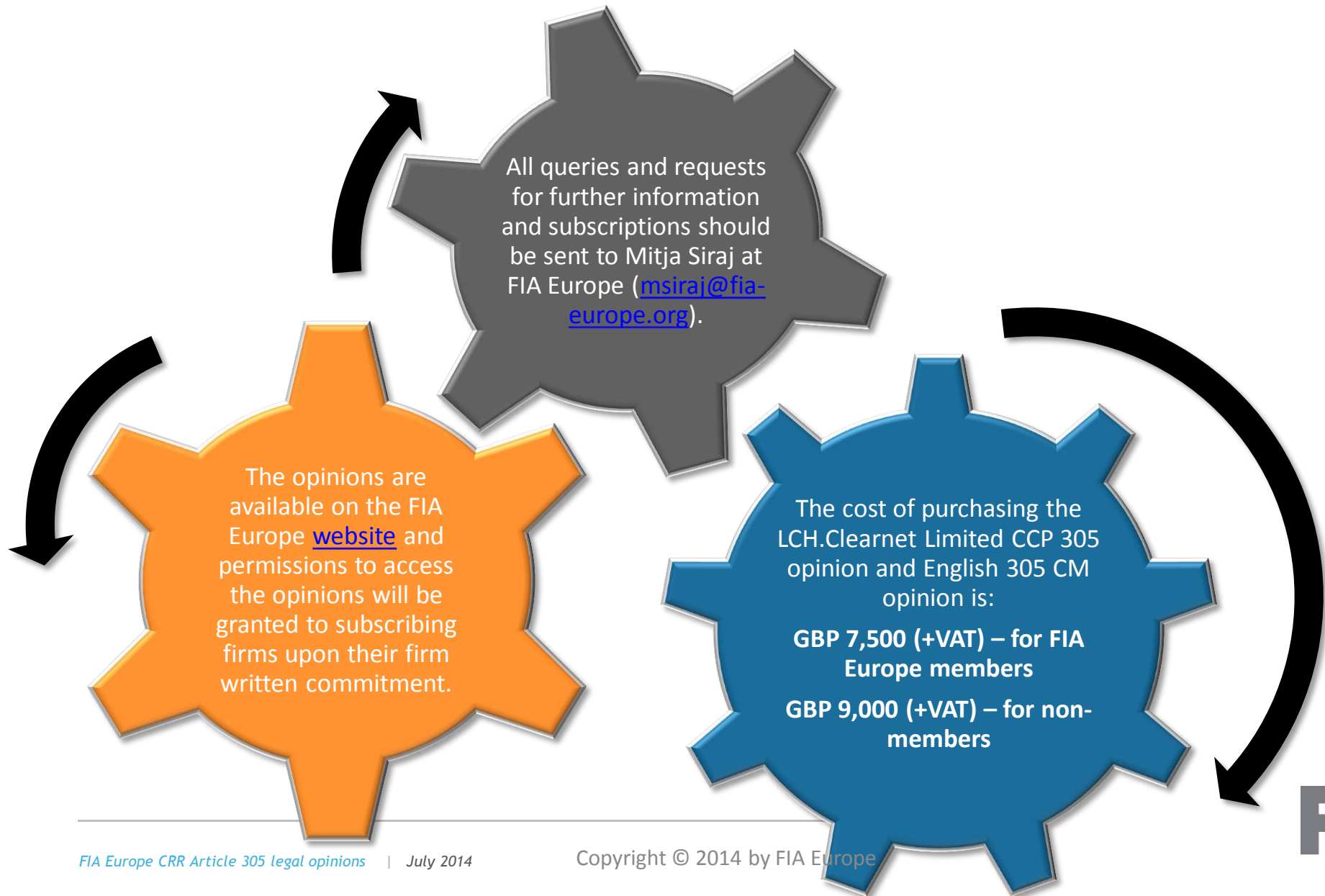
This Memorandum is given for the benefit of our client, FIA Europe in relation to regulatory capital, accounting and reporting obligations arising by virtue of article 305 of the CRR ("**Regulatory Capital Obligations**"). This opinion may not, without our prior written consent, be relied upon for any other purpose or be disclosed to or relied upon by any other person, save that it may be disclosed without such consent to:

- a) Persons (excluding associate members) who have made arrangements with FIA Europe to subscribe to FIA Europe's opinions library and whose terms of subscription give them access to this Memorandum (each a "**subscribing member**") and their officers and employees for the purposes of Regulatory Capital Obligations;
- b) any competent authority supervising a subscribing member, and auditors and professional advisers of a subscribing member, solely as an evidential matter in support of their evaluation of such subscribing member's compliance with its Regulatory Capital Obligations; and
- c) any person to whom disclosure is required to be made by applicable law or court order or pursuant to the rules or regulations of any supervisory or regulatory body or in connection with any judicial proceedings,

on the basis that (i) such disclosure is made solely to enable any such person to be informed that an opinion has been given and to be made aware of its terms, and (ii) we do not assume any duty or liability to any person to whom such disclosure is made. Clifford Chance LLP does not have or assume any client relationship in connection therewith or assume any wider duty to any person in paragraphs (a) to (c) above.

In preparing this Memorandum, Clifford Chance LLP was instructed by FIA Europe and has not taken instructions from, nor does this Memorandum take account of the specific circumstances of, any subscribing member. This Memorandum has not been prepared in connection with, and is not intended for use in, any specific transaction. Furthermore this Memorandum is given on the basis that any limitation on the liability of any other adviser to FIA Europe or any other person, whether or not we are aware of that limitation, will not adversely affect our position in any circumstances.

COST and GETTING ACCESS TO THE OPINIONS



FAQs

1

- **Do firms need to use any particular client clearing agreement in order to benefit from the 305 opinions?**
- No, the opinions are not given with respect to any particular client clearing agreement, although the CM 305 opinions acknowledges some of the most commonly used industry standard client clearing agreements.

2

- **If a client doesn't meet all the 305(2) requirements, does it automatically qualify for a 4% risk weight?**
- No, such clients still need to meet the legal opinion requirement in Article 305(2)(c). FIA Europe is considering procuring such legal opinion and is still working on the relevant analysis.

3

- **Will FIA Europe obtain additional 305 opinions to cover other CCPs and other CM jurisdictions?**
- FIA Europe is very seriously considering to cover some other EU CCPs and CM jurisdictions (e.g. Germany, France, Italy, etc.) in due course. Some CCPs (e.g. Eurex Clearing AG) have commissioned their own opinions.

4

- **Can a CM or a law firm purchase the 305 opinions?**
- No, only prudentially regulated clients of clearing members (which includes CM affiliates) can purchase these opinions.

5

- **If a client is located outside Europe, can it still benefit from the FIA Europe 305 opinions?**
- FIA Europe 305 opinions were issued to satisfy the requirements in Article 305(2) of Regulation (EU) No 575/2013 (CRR) and counsel did not consider any non-EU capital regime. Therefore it is up to non-EU clients to assess and make a decision as to whether these opinion meet their local regulatory capital requirements.

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