

FIA Legal Opinions Primer



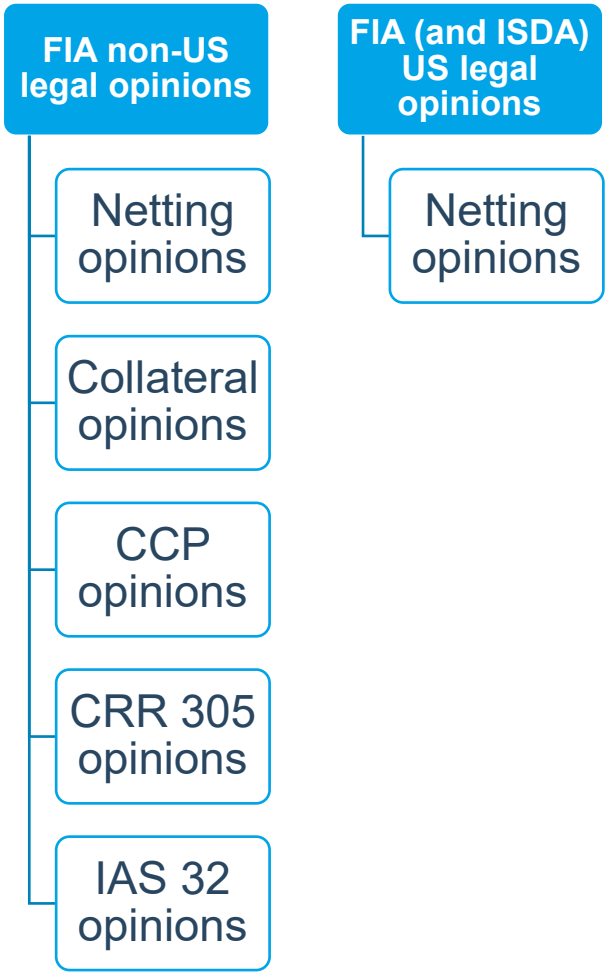
Tuesday, 13 October 2020



Agenda

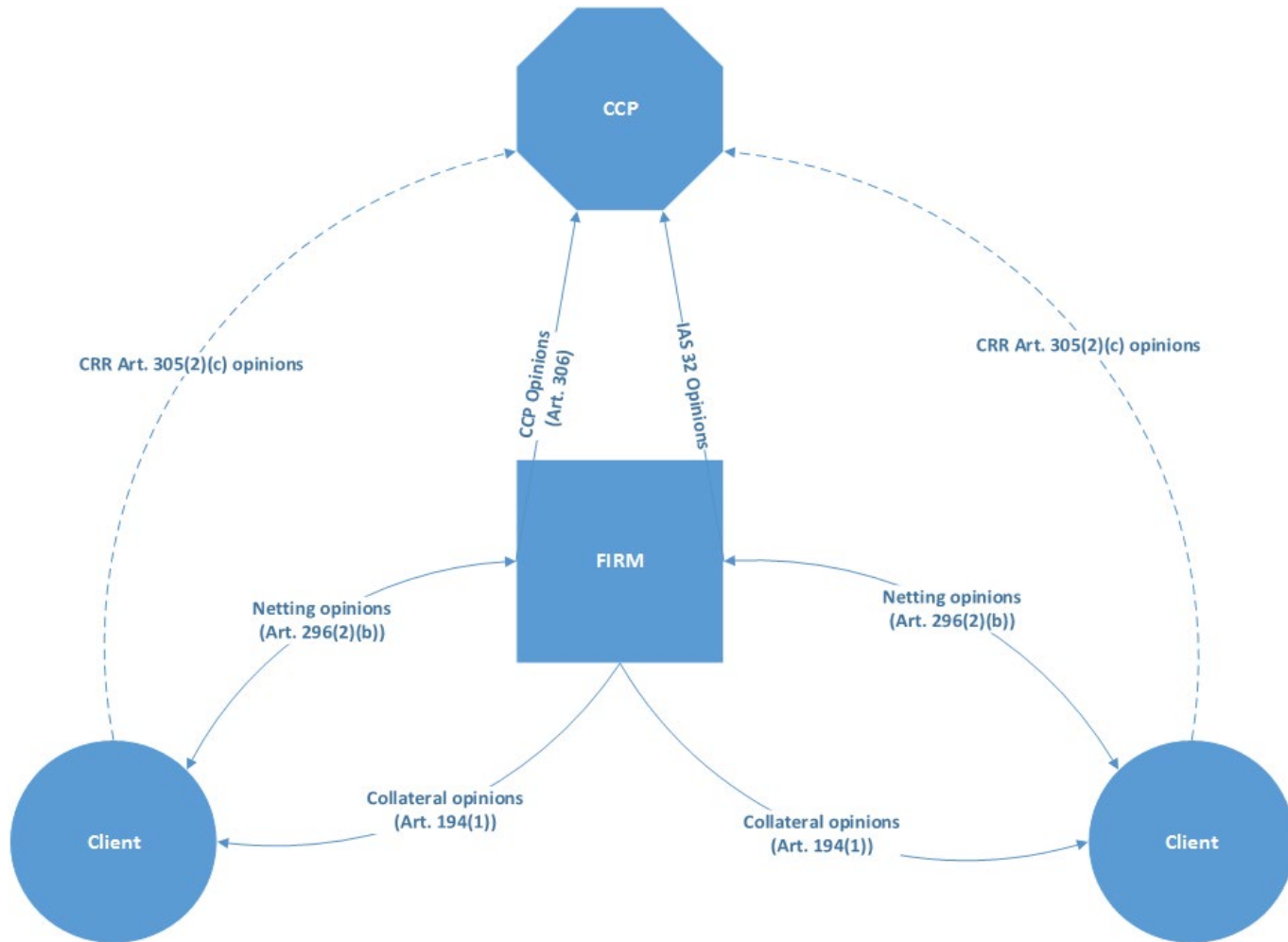
- Introduction
- FIA Legal Opinions Library – Europe + US
- FIA legal opinion types
- High-level structure/scope of FIA legal opinions
- World-wide coverage
- Capital requirements in the context of clearing – overview and types of opinions
- Structure of 305 opinions
- Indirect clearing supplemental netting opinions
- Brexit reports
- Reliance on FIA opinions
- Legal opinion review process – NCCLs and opinion updates
- How to access FIA legal opinions?
- Subscription and ‘add-on’ model
- FAQs

FIA US and Non-US legal opinions



FIA, jointly with ISDA, also maintains netting opinions for U.S. FCMs addressing enforceability of the liquidation and credit support provisions of commonly used futures account agreements and a Cleared Derivatives Addendum upon a customer's default or insolvency. These netting opinions currently cover 22 jurisdictions. FIA members may access these opinions at no charge in the [US FIA Documentation Library](#).

FIA legal opinions library - Europe



High-level structure/scope of FIA opinions

Netting opinions

- 61 opinions
- Based on 'Category 1' or 'Category 2' opinion templates
- One opinion letter with many legal opinions
- Netting
- Set-off
- TTCA
- Necessary/desirable amendments
- FIA Terms of Business 2018 and pre-2018 versions
- FIA Clearing Module
- ISDA/FIA Addendum

Collateral opinions

- 42 opinions
- Based on 'Situs' or 'Non-situs' opinion templates
- Effectiveness of FIA security interest arrangements
- TTCA covered in the netting opinions

CCP opinions

- 17 CCP opinions
- Enhanced template
- All CCP services typically covered
- Netting (including TT Margin/cash)
- Set off
- Account Segregation
- Bankruptcy remoteness of collateral

CRR 305 opinions

- 3 CCP 305(2)(c) opinions and 4 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)

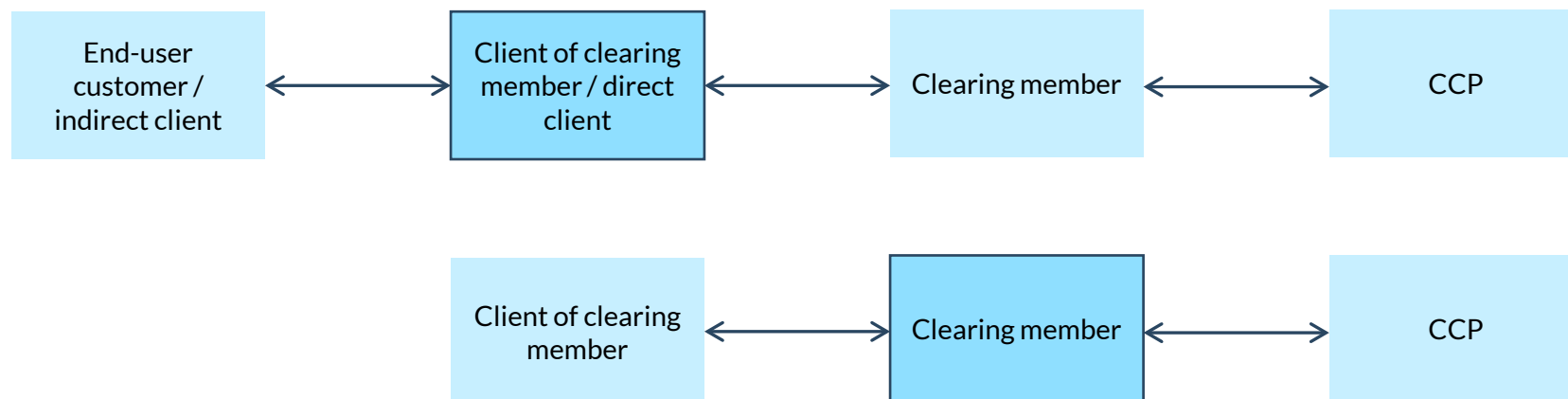
IAS 32 opinions

- 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

SUBSCRIPTION MODEL				ADD-ON MODEL
Netting and collateral opinions		CCP opinions		Netting opinions
Australia	Italy	England & Wales	LCH Ltd	Bahrain
Austria	Japan	England & Wales	LME Clear	Bulgaria
Bahamas	Jersey	France	LCH SA	Czech Republic
Belgium	Luxembourg	England & Wales	ICE Clear Europe	Dubai (DIFC)
Bermuda	Malta	Germany	Eurex Clearing	Estonia
Brazil (No Collateral)	Malaysia	Sweden	Nasdaq OMX Clearing	Gibraltar
British Virgin Islands	Netherlands	Italy	CC&G	Hungary
Canada (Ontario)	Norway	Germany	European Commodity Clearing (ECC)	Indonesia
Canada (Quebec)	Poland	Singapore	Singapore Exchange Derivatives Clearing	Latvia
Cayman Islands	Portugal	Australia	ASX Clear (Futures)	Liechtenstein (Netting + Collateral)
Cyprus	Scotland	Hong Kong	HKFE Clearing Corporation Limited (HKCC)	Mauritius
Denmark	Singapore	Hong Kong	SEHK Options Clearing House Ltd (SEOCH)	Mexico
England & Wales	South Africa	Spain	BME Clearing	Monaco
Finland	South Korea	Brazil	B3 (formerly BMFBovespa)	New Zealand
France	Spain	Hong Kong	Securities Clearing (HKSCC)	Peru
Germany	Sweden	Mexico	Asigna Compensacion y Liquidacion	Russia
Greece	Switzerland	Canada	Canadian Derivatives Clearing Corporation	Slovenia
Guernsey	Taiwan			Thailand
Hong Kong	Turkey			
India	UAE (No Collateral)			
Ireland	United States of America			
Israel				

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

CRR, CRR II and IFR

- CRR was amended in 2019 with most new provisions starting to apply on 28 June 2021, including changes to articles relevant for legal opinions (e.g. changes to CRR Article 305)
- IFR introduces new legal opinion requirements for investment firms (see Articles 25 and 31 of IFR). Most of IFR capital requirements start to apply on 26 June 2021.

Capital basics

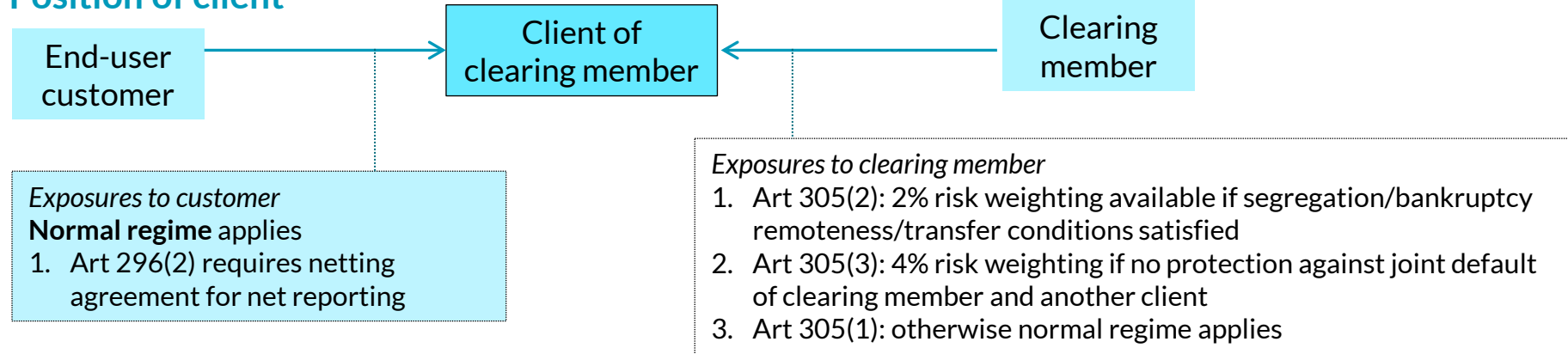
- Reg cap = [8]% * [risk weight] * [exposure]
- Risk weight differs according to counterparty identity
- Exposure may be net or gross

Accounting basics

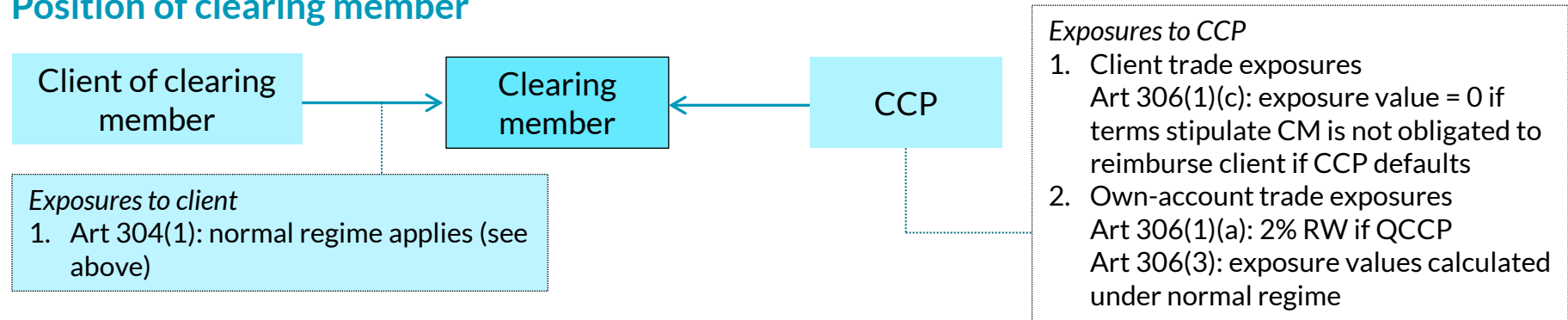
- Balance sheet asset may be reduced by liability
- Or maybe both asset and liability should be recognised on opposite sides of sheet

Capital requirements – exposures to clients

Position of client

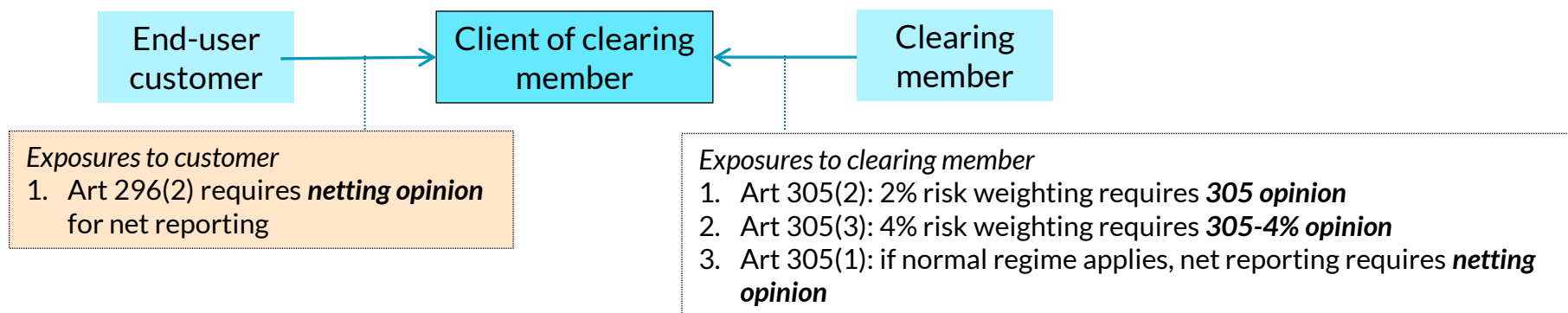


Position of clearing member

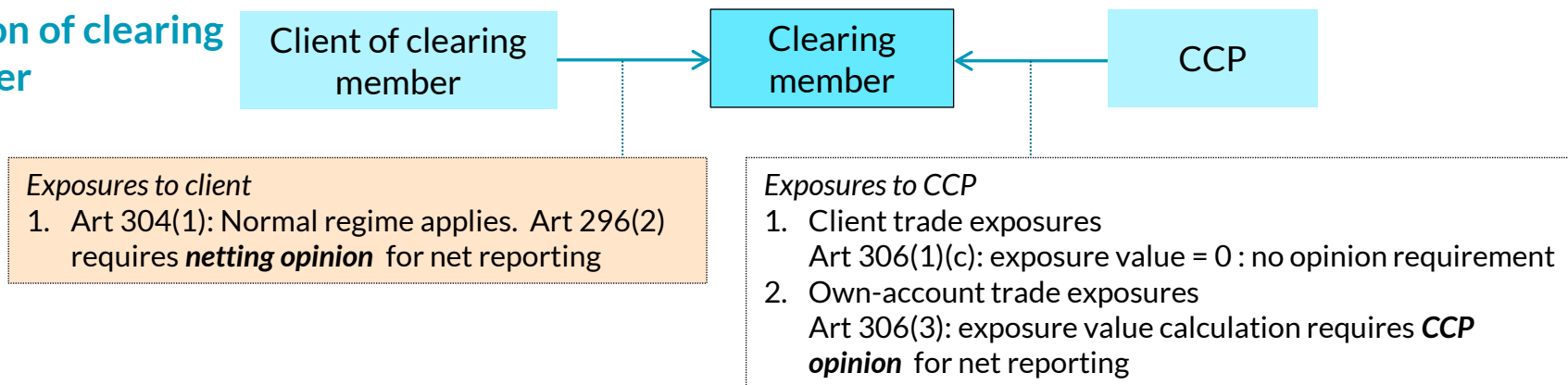


Capital requirements – netting opinions

Position of client

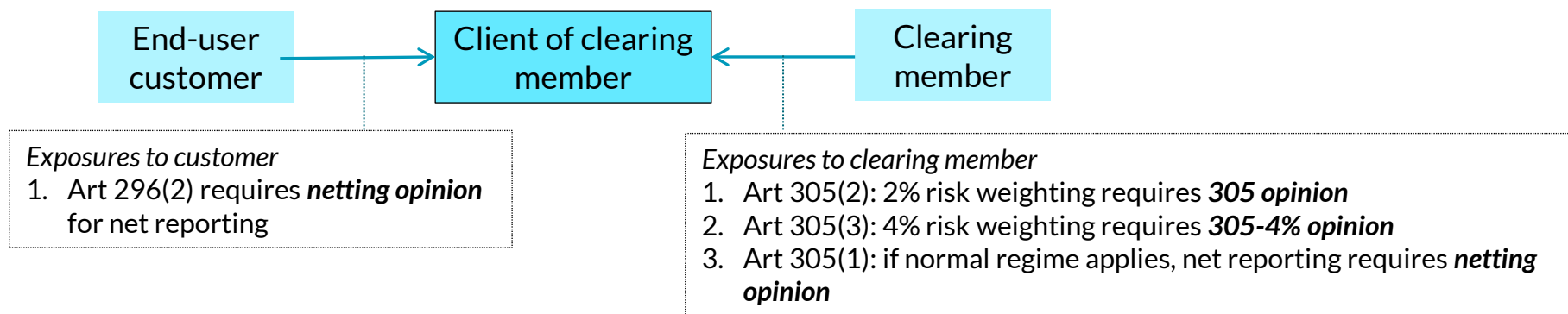


Position of clearing member

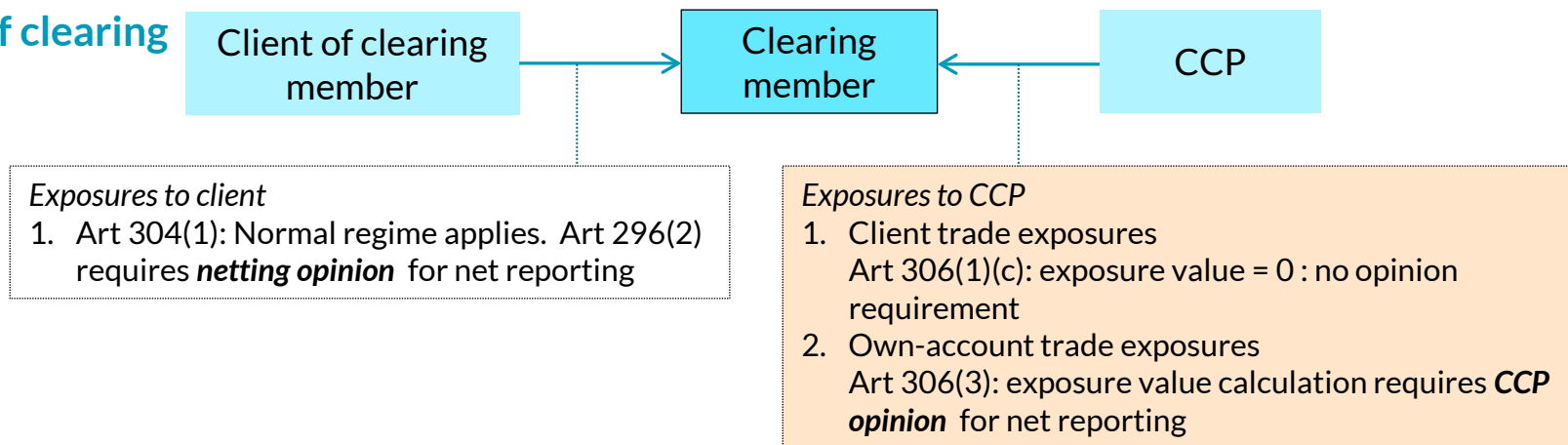


Capital requirements – CCP opinions

Position of client

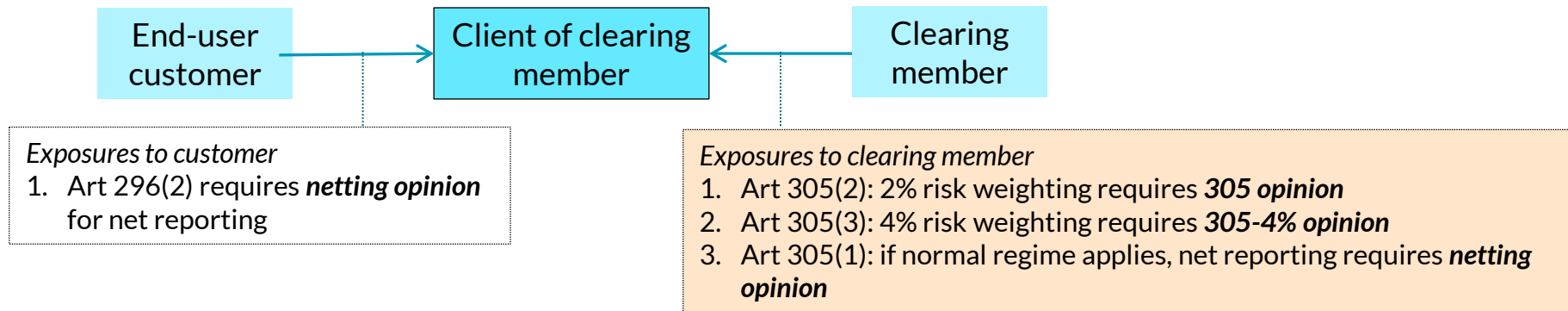


Position of clearing member

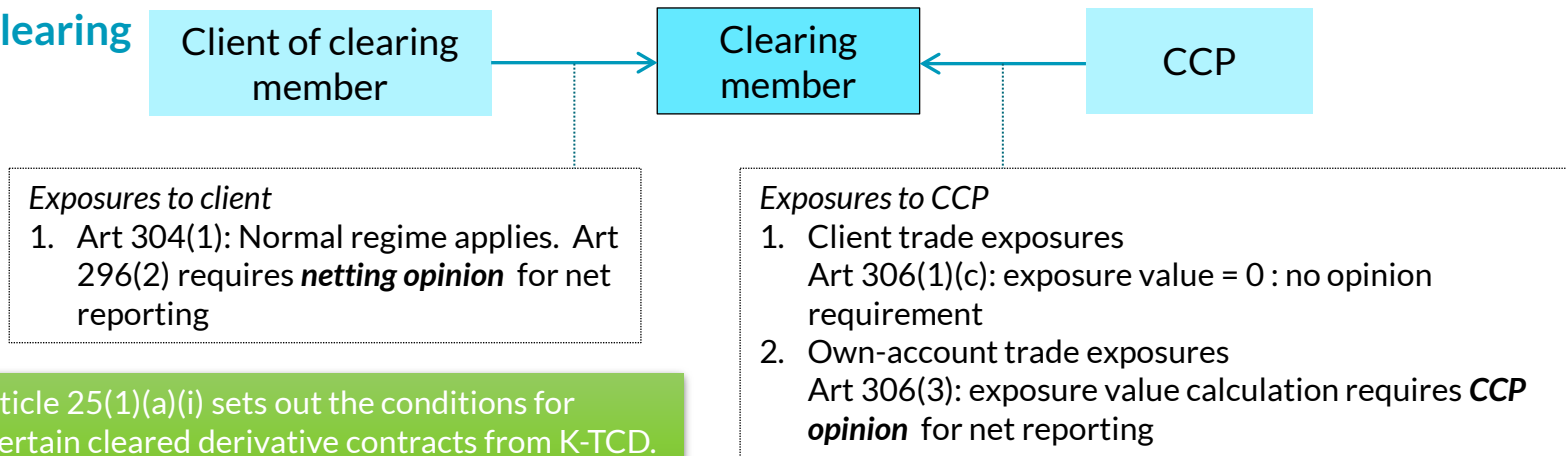


Capital requirements – 305 opinions

Position of client

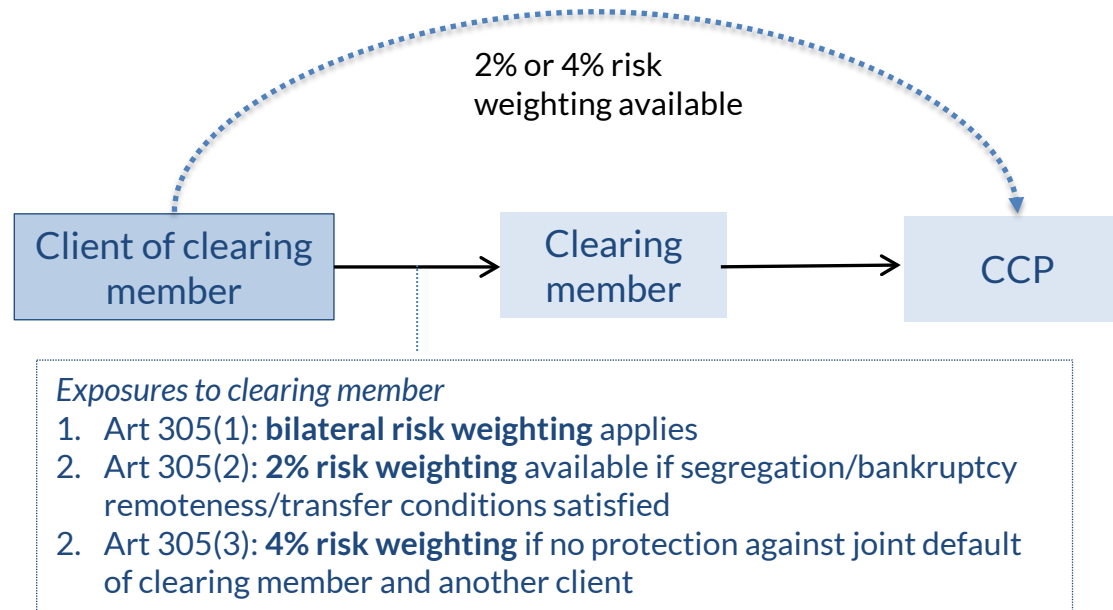


Position of clearing member



NEW: IFR Article 25(1)(a)(i) sets out the conditions for exemption of certain cleared derivative contracts from K-TCD. These conditions are equivalent to CRR Article 305(2).

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



Indirect Clearing Supplemental Netting Opinions

- Certain FIA Indirect Clearing Terms contain **amendments to the netting provisions** set out in the Terms of Business 2018 and the PCA 2011.
- For example, the 2018 BOSA/GOSA CM-DC Terms and the 2018 BOSA CM-DC Terms have been amended to provide for the determination and payment of separate Cleared Set Termination Amounts for each Cleared Transaction Set (and an equivalent mechanism for Additional CCPs) on the occurrence of a Liquidation Date following a Client Event of Default instead of the determination and payment of a single net Liquidation Amount.
- We were advised that **supplemental netting opinions were recommended** for firms using relevant FIA Indirect Clearing Terms to take into account the amendments to the netting provisions.
- FIA obtained the Indirect Clearing Supplemental Opinions for **England & Wales, Germany, France and Switzerland**. They are available for purchase to members and non-members for a one-off fee.



Brexit Reports

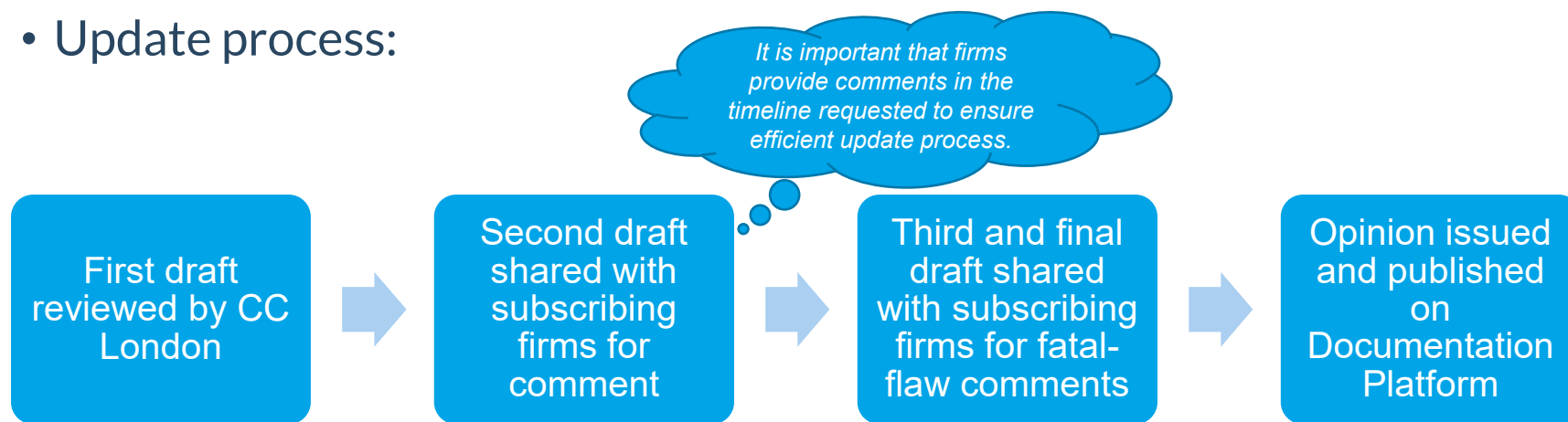
- FIA instructed Clifford Chance to assess and identify those aspects of our English law opinions (netting, collateral, CCP, CRR Article 305 and IC Supplemental Netting opinions) that will require modification and / or additional analysis as a result of the UK's exit from the European Union and in particular following the end of the transition period, which is due to expire at 11pm (GMT) on 31 December 2020.
- Brexit reports are available to the subscribing firms free of charge and will be published on the Documentation Platform shortly.
- At this stage and on the basis of the assumptions set out in the Brexit Reports, Clifford Chance have not identified any critical / material changes required to the relevant legal opinions that will affect the conclusions set out therein. Most of the changes that they have identified relate to updating legislative references and reflecting the relevant statutory instruments and ending of various reciprocal arrangements between the EU and the UK. Overall, as a result of the domestication of EU law into English law they do not expect the substance of the provisions to be materially different.

Reliance on FIA legal opinions

- FIA legal opinions can be relied on for regulatory capital purposes by subscribing firms and their affiliates, provided that the names of affiliates that wish to rely on the opinions have been communicated to FIA.
- Firms that have not subscribed to FIA opinions and have instead obtained them from any other source cannot rely on them.
- FIA legal opinions are prepared on the basis of instructions from FIA in the context of the netting and collateral requirements of the Basel III capital rules in the EU and the US.
- FIA legal opinions can be shared by the subscribing firms with
 - the officers, employees, auditors and professional advisers of any addressee or any subscribing member;
 - 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; and
 - any competent authority supervising a subscribing member,on the basis that (i) such disclosure is made solely to enable any such person to be informed that an opinion letter has been issued and to be made aware of its terms but not for the purposes of reliance, and (ii) we do not assume any duty or liability to any person to whom such disclosure is made and in preparing this opinion letter we have not had regard to the interests of any such person.

Legal opinion review process – NCCLs and opinion updates

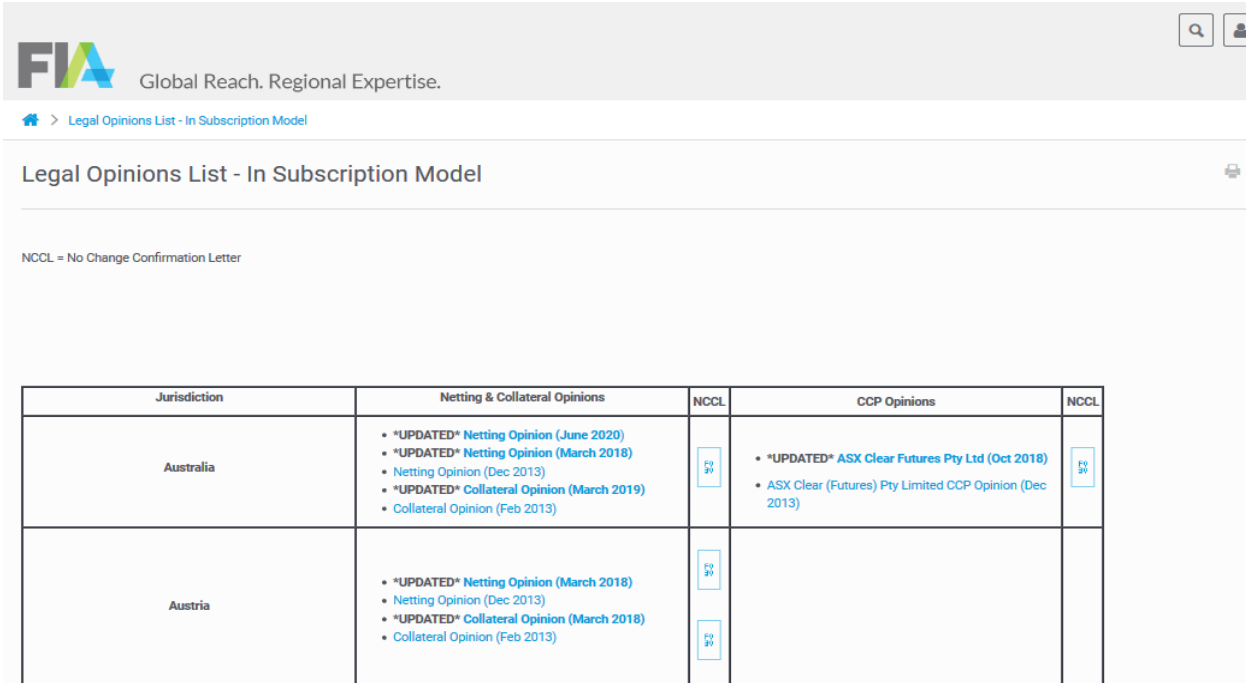
- What are ‘no change confirmation letters’ (NCCLs)?
- Reviewing v. updating the opinions
- Some firms are subject to capital regimes that require them to review legal opinions on an annual basis
- Update process:



- Legal opinions WG – all subscribing firms are eligible to participate in the WG

How to access FIA legal opinions?





- FIA hosts its legal opinions on FIA [Documentation Platform](#) (not on FIA website).
- Access to FIA legal opinions is restricted to the FIA subscribing firms (member and non-member firms).



FIA Global Reach. Regional Expertise.

Legal Opinions List - In Subscription Model

NCCL = No Change Confirmation Letter

Jurisdiction	Netting & Collateral Opinions	NCCL	CCP Opinions	NCCL
Australia	<ul style="list-style-type: none"> • *UPDATED* Netting Opinion (June 2020) • *UPDATED* Netting Opinion (March 2018) • Netting Opinion (Dec 2013) • *UPDATED* Collateral Opinion (March 2019) • Collateral Opinion (Feb 2013) 		<ul style="list-style-type: none"> • *UPDATED* ASX Clear Futures Pty Ltd (Oct 2018) • ASX Clear (Futures) Pty Limited CCP Opinion (Dec 2013) 	
Austria	<ul style="list-style-type: none"> • *UPDATED* Netting Opinion (March 2018) • Netting Opinion (Dec 2013) • *UPDATED* Collateral Opinion (March 2018) • Collateral Opinion (Feb 2013) 	 		



Subscription model and 'Add-on' model

- FIA legal opinions are available to member and non-member firms. Non-members pay a premium subscription fee.
- In 2018, FIA introduced an annual 'tiered' subscription model for certain legal opinions. Subscribers required to sign a subscription agreement.
- In 2019, a variation of the annual subscription model ('Add-on Model') was introduced for less in-demand netting opinions.
- Subscription year for both models runs from 1 October to 30 September. Both subscription models are reviewed on an annual basis and opinions can be moved between the models (once a year) depending on the number of subscribers. Subscription renewals are automatic, unless cancelled by subscribing firms.
- FIA reaches out to subscribing firms over summer in advance of subscription model anniversary to confirm subscription selection and pricing.
- Subscribers are free to amend their selection of opinions during subscription year.
- Key difference between the 'tiered' subscription model and the 'add-on' model:
 - **Tiered subscription model:** pricing depends on the number of opinions that each firm wishes to subscribe to (i.e. annual fee does not depend on demand for each opinion, but rather on the 'tier' that each subscribing firm is in);
 - **Add-on model:** pricing depends on the number of subscribing firms for each opinion (i.e. the more firms subscribe to the opinion in the 'Add-on' model, the cheaper the annual fee).

Subscription Model Pricing 2020/21

Tier	Netting
Platinum 30+	£ 36,000
Gold 20+	£ 27,000
Silver 10+	£ 16,000
Bronze 1+	£ 5,000

Tier	Collateral
Platinum 30+	£ 44,000
Gold 20+	£ 35,000
Silver 10+	£ 20,000
Bronze 1+	£ 6,000

Tier	CCP
Platinum 8+	£ 16,000
Gold 4+	£ 10,000
Silver 1+	£ 5,000

Tier	Incremental Unit GBP
Platinum 30+	£ 750
Gold 20+	£ 1,000
Silver 10+	£ 1,500
Bronze 1+	£ 2,000
Off the shelf - 3 yr	£ 10,000

Tier	Incremental Unit GBP
Platinum 30+	£ 1,000
Gold 20+	£ 1,250
Silver 10+	£ 1,500
Bronze 1+	£ 2,000
Off the shelf - 3yr	£ 10,000

Tier	Incremental Unit GBP
Platinum 8+	£ 1,000
Gold 4+	£ 1,500
Silver 1+	£ 2,000
Off the shelf - 3yr	£ 10,000

Library Opinion count **43**

41

17

Sample Calculation / Example: A firm would like to subscribe to 23 Netting Opinions, 4 Collateral Opinions and 8 CCP Opinions. For the first 20 Netting Opinions the Tier is “Gold 20+” 27,000GBP. The incremental 3 Netting Opinions are under Tier “Incremental Gold 20+” (1,000 GBP x 3) = 3,000GBP. Total Netting 30k GBP. The 1st Collateral Opinion would fall under Tier “Bronze 1+” 6,000 GBP. The Incremental 3 Collateral Opinions are under Tier “Incremental Bronze 1+” (2,000 GBP x 3) = 6,000 GBP. Total Collateral 12k GBP. Lastly, the 8 CCP Opinions would fall under Tier “Platinum 8+” and cost would be 16,000 GBP.

Grand Total: 30k Netting + 12k Collateral + 16k CCP = 58K GBP.

Frequently Asked Questions

Q1 - Why do the opinions not opine on the availability of any judicial remedy in respect of the enforceability of any net obligation?

Answer: This is a standard carve-out included in FIA opinions, which is aimed at limiting the opinion to the process of getting to the net sum by virtue of the operation of the netting provision – the opinions do not extend to what happens once such single net sum is produced. Therefore, each opinion addresses the issue of whether netting works, but does not cover whether the single net sum resulting from the netting process is enforceable (i.e. whether the party in question can claim/get its money corresponding to the net sum).

Q2 - Why do opinions not always confirm that a safe harbour applies and instead merely outline the requirements for the safe harbour to apply?

Answer: This can apply to either a collateral opinion or a netting opinion. The answer is distinct to each jurisdiction but in many cases it is because either the law is unclear or it would require a factual review of the agreement (for example, if only certain categories of transaction are protected then any opinion would need to include additional assumptions regarding the transactions that have been entered into).



Frequently Asked Questions

Q3 - Why are the opinions limited to Transactions which are capable, under their governing laws, of being terminated and liquidated in accordance with the FIA Netting Provision?

Answer: This provision is based on the fact that counsel have not reviewed each individual Transaction and its terms and are therefore unable to give a view on them. In any case, what this means in practice is that counsel only carve out those Transactions which for whatever reason are not capable of being terminated, liquidated or netted in accordance with the Netting Provision; netting still works for the remaining Transactions, with the "problematic" ones omitted from the netting set / calculation. Please also note that this language features in a number of other industry opinions.

Q4 - Why do the opinions sometimes refer to set-off in the context of netting provisions?

Answer: Many jurisdictions do not draw a distinction between netting arrangements and set-off arrangements and correspondingly their analysis and qualifications can refer to set-off in the context of netting arrangements. In other cases, it is not clear whether a court what characterise a netting arrangement as a set-off arrangement and in these cases it is possible for some common qualifications to be relevant to both a netting provision and a set-off provision.

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C H A N C E

