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Italy / Prudential Regulation / CCP / CC&G

~~The Futures and Options Association~~
FIA Europe
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Milan, ~~27 March 2013~~25 November 2014

NETTING ANALYSER LIBRARY

Dear Sirs

CCP Opinion in relation to Cassa di Compensazione e Garanzia S.p.A.

You have asked us to give an opinion in respect of the laws of Italy ("**this jurisdiction**") as to the effect of certain netting and set-off provisions and collateral arrangements in relation to Cassa di Compensazione e Garanzia S.p.A. (the "**Clearing House**") as between the Clearing House and its clearing members (each a "**Member**").

We understand that your requirement is for the enforceability and validity of such netting and set-off provisions and collateral arrangements to be substantiated by a written and reasoned opinion letter.

References herein to "**this opinion**" are to the opinion given in Section 3.

1. TERMS OF REFERENCE

1.1. Except where otherwise defined herein, terms defined in the Rules of the Clearing House have the same meaning in this opinion letter.

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1.2. The opinions given in Section 3 are in respect of a Member's powers under the Clearing House Documentation as at the date of this opinion. We express no opinion as any provisions of the Rules of the Clearing House other than those on which we expressly opine.

1.3. This opinion relates to the service provided by the Clearing House in respect of clearing of listed futures and option transactions. This opinion does not relate to unlisted derivatives, as unlisted derivatives are not cleared by the Clearing House.

~~1.3.~~1.4. The opinions given in Section 3.8 are given only in relation to Non-cash Collateral comprising securities credited to an account.

~~1.4.~~1.5. Definitions

In this opinion, unless otherwise indicated:

a) "**Clearing Agreement**" means a Model Form Clearing Agreement or an Equivalent Clearing Agreement;

b) "**Equivalent Clearing Agreement**" means any agreement or other document entered into by or on behalf of a Member pursuant to which such Member agrees to be bound by the Rules as a Member but which contains no other provisions which may be relevant to the matters opined on in this opinion letter;

c) "**Model Form Clearing Agreement**" means the clearing membership agreement entered into between each Member and the Clearing House in the form attached hereto at Annex 1;

d) "**Assessment Liability**" means a liability of a Member to pay an amount to the Clearing House (including a contribution to the assets or capital of the Clearing House, or to any default or similar fund maintained by the Clearing House); but excluding:

i. any obligations to provide margin or collateral to the Clearing House, where calculated at any time by reference to Contracts open at that time;

ii. membership fees, fines and charges;

iii. reimbursement of costs incurred directly or indirectly on behalf of or for the Member or its own clients;

iv. indemnification for any taxation liabilities;

v. payment or delivery obligations under Contracts; or

vi. any payment of damages awarded by a court or regulator for breach of contract, in respect of any tortious liability or for breach of statutory duty.

e) "**Bankruptcy Law**" means royal decree no. 267 of 16 March 1942

f) "**Clearing House Documentation**" means the Clearing Agreement, and Rules;

g) "**Client Account**" means the "*conto terzi omnibus*" or "*conto terzi segregato*" opened with the Clearing House in accordance with Article B.3.1.2 of the Rules, where Contracts originating from transactions executed by the Member on behalf of its clients are registered, including sub-accounts of the same pertaining to each individual client of the Member (if any);

h) "**Consolidated Banking Act**" means Legislative Decree no. 385 of 1 September 1993;

i) "**Consolidated Financial Act**" means Legislative Decree no. 58 of 24 February 1998;

j) "**Contract**" means a Posizione Contrattuale (as defined in the Rules) which is registered at the Clearing House;

k) "**Decree 170**" means legislative decree no. 170 of 21 May 2004;

l) "**Decree 210**" means legislative decree no. 210 of 12 April 2001;

m) "**EMIR**" means Regulation (EU) no 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories;

~~m)~~n) "**House Account**" means the "*conto proprio*" opened with the Clearing House in accordance with Article B.3.1.2 of the Rules, where Contracts originating from transactions executed by the Member on its own behalf are registered;

~~n)~~o) "**Joint Regulation**" means the joint regulation issued on 22 February 2008 by the Bank of Italy and the CONSOB on central depositories, settlement services, guarantee systems and related management companies;

~~o)~~p) "**Party**" means the Clearing House or the relevant Member;

~~p)~~q) "**Non-cash Collateral**" means the non-cash collateral provided to the Clearing House as margin under the Clearing House Documentation;

~~q)~~r) references to the word "**enforceable**" and cognate terms are used to refer to the ability of a Party to exercise its contractual rights in accordance with their terms and without risk of successful challenge. We do not opine on the availability of any judicial remedy;

~~r)~~s) "**Rules**" means the rules of the Clearing House in force as at the date of this opinion;

~~s)~~t) references to a "**section**" or to a "**paragraph**" are (except where the context otherwise requires) to a section or paragraph of this opinion (as the case may be).

2. ASSUMPTIONS

We assume the following:

2.1. That, **except** with regards to the provisions discussed and opined on in this opinion letter, the Clearing House Documentation and Contracts are legally binding and enforceable against both Parties under their governing laws.

2.2. That each Party has the capacity, power and authority under all applicable law(s) to enter into the Clearing House Documentation and Contracts; to perform its obligations under the Clearing House Documentation and

Contracts; and that each Party has taken all necessary steps to execute and deliver and perform the Clearing House Documentation and Contracts.

2.3. That each Party has obtained, complied with the terms of and maintained all authorisations, approvals, licences and consents required to enable it lawfully to enter into and perform its obligations under the Clearing House Documentation and Contracts and to ensure the legality, validity, enforceability or admissibility in evidence of the Clearing House Documentation in this jurisdiction.

2.4. That both Parties have properly executed either a) the Model Form Clearing Agreement, in substantially identical form to that attached at Annex 1 or b**)** an Equivalent Clearing Agreement.

2.5. That the Clearing House Documentation has been entered into prior to the commencement of any insolvency procedure under the laws of any jurisdiction in respect of either Party.

2.6. That each Party acts in accordance with the powers conferred by the Clearing House Documentation and Contracts; and that (save as a consequence of the opening of insolvency proceedings against the Clearing House), each Party performs its obligations under the Clearing House Documentation and each Contract in accordance with their respective terms.

2.7. That, apart from any circulars, notifications and equivalent measures published by the Clearing House in accordance with the Clearing House Documentation, there are not any other agreements, instruments or arrangements between the Parties which modify or supersede the terms of the Clearing Agreement.

2.8. That the Member is at all relevant times solvent and not subject to insolvency proceedings under the laws of any jurisdiction.

2.9. That (save as discussed at paragraphs 3.5 and 3.6) the obligations assumed under the Clearing House Documentation and Contracts are mutual between the Parties, in the sense that the Parties are each personally and solely liable as regards obligations owing by it and is solely entitled to the benefit of obligations owed to it.

2.10. That no provision of the Clearing House Documentation other than an Equivalent Clearing Agreement that is necessary for the giving of our opinions and advice in this opinion letter has been altered in any material respect.

3. OPINION

On the basis of the foregoing terms of reference and assumptions and subject to the qualifications set out in Section 4 below, we are of the following opinions.

3.1. Insolvency Proceedings

The only bankruptcy, composition, rehabilitation or other insolvency or reorganisation procedures to which the Clearing House could be subject under the laws of this jurisdiction, and which are relevant for the purposes of this opinion, are:

(a) *amministrazione straordinaria* ("**Extraordinary Aministration**") under Article 70 to 70 of the Consolidated Banking Act, by virtue of the cross-reference under Article 83 of the Consolidated Financial Act; and

(b) *liquidazione coatta amministrativa* ("**Compulsory Administrative Liquidation**") under Article 80 of the Consolidated Banking Act, by virtue of the cross-reference under Article 77 and Article 83 of the Consolidated Financial Act.

3.2. Special provisions of law

The following special provisions of law apply to Contracts by virtue of the fact that the Contracts are, or relate to, exchange-traded derivative products and are cleared through a central counterparty:

- Decree 210 implementing Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems.

3.3. Recognition of choice of law

The choice of law provisions of Article 15 of the Clearing Agreement would be recognised under the laws of this jurisdiction, even if the Member is not incorporated, domiciled or established in this jurisdiction.

3.4. Netting and Set-off: General

The Rules do not address the subject of the Clearing House own default. Accordingly, the Rules do not contain any netting or set-off provisions dealing with the close-out of the Contracts and the offset of mutually owing claims in the event of the insolvency of the Clearing House.

As a consequence, the statutory provisions of Italian law will apply to govern the unwinding of the opened positions upon the insolvency of the Clearing House.

In this respect, a distinction must be made between Compulsory Administrative Liquidation and Extraordinary Administration.

Compulsory Administrative Liquidation

Pursuant to Article 76 of the Bankruptcy Law and Article 203 of the Consolidated Financial Act, in the event that the Clearing House is made subject to Compulsory Administrative Liquidation, all financial derivatives transactions outstanding between the Member and the Clearing House, as of the date of commencement of the Compulsory Administrative Liquidation, are automatically terminated. The amount due in connection with the termination of each transaction will be determined either as (a) the difference between the contract price and the value of the relevant underlying assets or (b) as the "replacement cost" of the transaction, calculated "at market values", where "replacement cost" is not defined though should be intended as the cost of entering into a new transaction economically equivalent to the terminated one. The choice between (a) and (b) ultimately lies with the insolvency representative or the court presiding over the Compulsory Administrative Liquidation. However, the method of the difference price/value of underlying is clearly inapplicable in respect of certain types of financial derivatives transactions.

The amounts so determined, to the extent they are mutually owing between the parties, may then be offset and only the resulting balance will be due by one party to the other at the option of the Member (please see paragraphs 3.5 and 3.6 below in respect of netting between the House Account and the Client Account and cross-product netting).

Extraordinary Administration

Article 76 of the Bankruptcy Law and Article 203 of the Consolidated Financial Act only apply to bankruptcy/liquidation proceedings (such as Compulsory Administrative Liquidation).

Extraordinary Administration is not a liquidation proceeding, but rather one primarily aimed at rehabilitating the Clearing House so as to allow it to continue to carry on its business. Accordingly, the mandatory close-out of the opened positions under Article 76 of the Bankruptcy Law and Article 203 of the Consolidated Financial Act would not occur upon the Clearing House becoming subject to Extraordinary Administration, unless and until the Extraordinary Administration is converted into Compulsory Administrative Liquidation).

The Extraordinary Administration is initiated by the Ministry of Economy upon the Bank of Italy's proposal, in case of material regulatory breaches, material losses or upon request by the Clearing House board or general meeting. The Extraordinary Administration can then be converted into Compulsory Administrative Liquidation if the Clearing House is insolvent. During the Extraordinary Administration, the appointed administrator cannot elect to terminate all or some of the outstanding Contracts (i.e. "cherry pick").

3.5. Netting and Set-Off: House Accounts and Client Accounts

Where an automatic close-out of the Contracts has occurred upon the commencement of a Compulsory Administrative Liquidation, it is debatable whether or not the net amount arising from the close-out of the Contracts registered in the Client Account would be aggregated with or netted against (in the latter case, at the option of the Member) the net amount arising from the close-out of the Contracts registered in the House Account.

In this connection, we note that the only provision of Italian law hinting at segregation between proprietary positions and client positions opened with the Clearing House by a Member is Article 55 of the Joint Regulation, pursuant to which the rules of a clearing house must establish, among other things, "*the procedures for recording contractual positions in compliance with the principle of separation between those deriving from transactions concluded by the participant for own account and those deriving from transactions concluded by the participant for customer account* ".

The law, however, does not clarify what the principle of separation referred to in Article 55 entails in practice, especially in the event of the insolvency of the Clearing House.

Because Members always deal as principals *vis à vis* the Clearing House, while their clients have no direct relationship with the Clearing House and, accordingly, no actionable claim against the insolvency estate, nothing in the law ~~seems~~would seem capable of preventing netting between House Account and Client Account. Had the legislator's intention been to keep the balance of proprietary trades separate from that of client trades, it would have been ~~necessary~~appropriate, in our view, for the law to elaborate further on the principle of separation, specifying, *inter alia*, how the principle interplays with the general rules of insolvency in the event of the insolvency of the Clearing House. In the absence of special provisions in this respect, it ~~would appear~~is not immediately apparent how the that the general rules on set-off in insolvency, as set out under Article 56 of the Bankruptcy law, ~~should apply without restrictions~~could be deemed disapplied in the case at hand.

That said, we note the following:

(i) Following the amendments enacted on 6 August 2013, Article 70 of the Consolidated Financial Act now provides that any posted margin (i) cannot be made subject to enforcement proceedings or precautionary measures initiated by the creditors of a Member of the Clearing House, and (ii) must be used solely in accordance with EMIR. Now, under EMIR the assets acquired in respect of an account must not be exposed to losses relating to different accounts. If netting could occur across different accounts, there would be a risk that this could in fact result in the margin posted in respect of the Client Account being used to cover losses pertaining to the House Account (or *vice versa*), in breach of Article 70 of the Consolidated Financial Act. This provides an argument suggesting that netting should in fact not occur between the Client Account and the House Account in the insolvency of the Clearing House;

(ii) on 20 May 2014 the Clearing House has been authorized by the Bank of Italy to operate as a central counterparty under EMIR. This implies that the Bank of Italy (and the college of regulators referred to in article 18 of EMIR) concluded that the Clearing House presently meets

the requirements for authorization as a central counterparty. Pursuant to Article 39 of EMIR, these requirements include the full segregation of the positions opened with a central counterparty in respect of different accounts, without netting across different accounts. This, in our view, suggests that the Bank of Italy maintained that the current framework (and, in particular, Article 55 of the Joint Regulation and Article 70 of the Consolidated Financial Act) is sufficient to prevent netting between the House Account and the Client Account.

3.6. Netting and Set-Off: Cross-Product Netting

Based on the same reasoning outlined under paragraph 3.5 above, ~~in the absence of contrary indication in the law, it appears reasonable~~there are arguments to maintain that the net amount arising from the close-out of the Contracts pertaining to a specific partition of the Clearing House ~~would~~should not be aggregated with or netted against the net amount arising from the close-out of the Contracts pertaining to all other partitions of the Clearing House.

3.7. Cash Collateral

Article 70 of the Consolidated Financial Act provides that any margin posted by a Member "*may not be ~~used for other purposes or be~~made subject to enforcement proceedings or precautionary measures ~~advanced~~initiated by the creditors of individual participants or the ~~operator of the system~~central counterparty, including ~~in cases where~~ upon the opening of bankruptcy proceedings~~ have been initiated~~. Any such margin may only be used in accordance with Regulation (UE) no. 648/2012*". As also pointed out by Italian scholars, this seems to suggest that, while the margin is transferred to the Clearing House so as to become property of the Clearing House, it is nonetheless to be regarded as a segregate estate (*patrimonio*), separate from the general estate of the Clearing House.

While this provision is primarily aimed at ensuring that posted margin is not distracted from its purpose of covering losses arising from the relevant Member default, the tenor of Article 70 ~~seems to also imply (although the legislator does not expressly say so)~~implies that the margin is also ring-fenced from actions by the creditors of the Clearing House, including "~~where~~upon the opening of bankruptcy proceedings [against the same~~] have been initiated",~~]", so that the relevant Member would have a right to the restitution of the margin with preference over all other creditors of the Clearing House. Moreover, the circumstance that margins can only be used in accordance with EMIR further

reinforces this conclusion, as under EMIR the margins covering the positions recorded in an account must not be exposed to losses connected to positions recorded in another account (which would be the case if the acquired margin could be used in satisfaction of the Clearing House's claims other than claims pertaining to the account in respect of which the relevant margin was posted).

~~If this reasoning is upheld by the competent bankruptcy court, then payments made by a Member to the Clearing House as cash margin would constitute an absolute transfer of cash but would nonetheless be regarded as a separate estate, so that, in the event of Insolvency Proceedings relating to the Clearing House, such cash would not be available to the Clearing House creditors generally.~~

~~While, as mentioned, it is not entirely clear whether or not cash margin posted by a Member would be deemed segregated for the benefit that Member only, or, conversely, available to the all creditors of the Clearing House generally, if cash margin is not deemed segregated for the benefit of the relevant Member, the amount of cash provided by such Member would in any event constitute a debt owed by the Clearing House to the Member as principal.~~

3.8. Non-cash Collateral

The reasoning under paragraph 3.7 as to whether and to which extent posted margin is segregated from the Clearing House own assets also apply to margin in the form of securities.

~~If margin in the form of securities is not deemed segregated for the benefit of the relevant Member, the cash value of such securities would in any event constitute a debt owed by the Clearing House to the Member as principal. This is because, upon the insolvency of the Clearing House and the unwinding of the opened positions, there would no longer be either legal or contractual grounds for keeping margin posted with the Clearing House. Accordingly, the Member will have a claim for the restitution of assets equivalent to those posted as margin; pursuant to Article 59 of the Bankruptcy Law, a claim to assets other than cash is converted into a claim to an amount of cash equal to the value of such assets in the event that insolvency proceedings are commenced against the debtor.~~

3.9. Members' Assessment Liabilities

A Member's Assessment Liability is as follows.

Article B.4.2 of the Rules and Article B.3.2 of the Instructions supplementing the Rules govern the establishment, the use and the replenishment of the default funds established by the Clearing House to partially cover the losses arising from a Member default.

A separate default fund is established for each of the partitions (*comparti*) in which the clearing system is divided.

Each Member is required to contribute to the default funds pertaining to the partitions to which it is a member, in an amount determined in accordance with the criteria published by the Clearing House. A failure to contribute will constitute an event of default on the part of the Member pursuant to Article B.6.1.1 of the Rules.

The amount of the contribution is adjusted on a monthly basis; however, the Clearing House has the right to increase the frequency of the adjustments if it deems it necessary to do so.

The Rules cap Member liability for a single default event. Pursuant to Article B.4.2.3, paragraphs 1 and 2 of the Rules, if the amount standing to the balance of a default fund is used to cover losses from a Member default, continuing members must immediately replenish used funds upon the Clearing House request; however, replenished funds cannot be used to cover losses from the default that caused the Clearing House to ask for the replacement, thereby limiting each member's loss sharing liability per single default to the value of their funded clearing fund deposit.

The Rules allow Members to withdraw from the system, thereby enabling them to cap liability. Pursuant to Article B.4.2.3, paragraph 3 of the Rules, if a Member has been requested to replenish the fund, it may notify the Clearing House that it wishes to withdraw from the relevant market, in which case it will not need to effect the replenishment.

If a call for replenishment is issued, the Clearing House will notify the Members of the date by which they may withdraw from the relevant market, thus avoiding the replenishment.

The withdrawal becomes effective only upon settlement of the outstanding Contracts of the withdrawing Member. For so long as the withdrawal has not yet become effective, the withdrawing Member will not be required to replenish the fund but the amounts that it had already contributed to the fund

before notifying its withdrawal will be still available to the Clearing House to cover other defaults occurring in the meantime.

4. QUALIFICATIONS

The opinions in this opinion letter are subject to the following qualifications:

1. In respect of many of the issues that must be resolved for the purposes of the opinions expressed in paragraph 3 - particularly those expressed in paragraph 3.4 to 3.8 - there may be little if no case law or legal literature available, or there may be contradictory case law and legal literature.

   Consequently, our opinions in paragraph 3 - particularly those in paragraph 3.4 to 3.8 - are sometimes the result of our reasoning and personal elaboration, by inference from the applicable legal framework, rather than reflect legal views commonly shared between legal scholars.

   We have not discussed at lengths the reasoning and elaboration underlying the conclusions set out in paragraph 3, as the arguments are very detailed and would have required an overly extensive analysis, which we understand would be beyond the scope of your instructions.

   Although we are confident that the arguments supporting the views expressed in paragraph 3 should be successful, you should be aware that there may sometimes be room for a different reasoning, leading to different, or partially different, conclusions.

2. Any judgment in respect of the Clearing House Documentation obtained in any foreign courts shall be recognized and enforced by the Italian courts, to the extent that enforcement by the Italian courts is sought, in accordance with, and subject to, the provisions of the EU Regulation No. 44/2001 dated 22 December 2000.

3. An Italian court may stay proceedings brought in such court if concurrent proceedings are being brought elsewhere.

4. Claims may be or become subject to claw back or to defence of set-off or counterclaim, and their enforcement may become barred through lapse of time.

5. Enforcement of obligations may be invalidated by reason of fraud.

There are no other material issues relevant to the issues addressed in this opinion which we wish to draw to your attention.

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~~This opinion is given for the sole benefit of the Futures and Options Association and such of its members (excluding~~We hereby consent to members of FIA Europe (other than associate members) ~~as subscribe to the Futures and Options Association's~~and their affiliates which have subscribed to FIA Europe's opinions library ~~(~~and whose terms of subscription give them access to this opinion~~).~~, (as evidenced by the records maintained by FIA Europe and each a "subscribing member") relying on the opinion. This opinion may not, without our prior written consent, be relied upon by or be disclosed to any other person ~~unless we otherwise specifically agree with~~save that it may be disclosed without such consent to:

(A) the officers, employees, auditors and professional advisers of any addressee or any subscribing member;

(B) any person ~~in writing, although we consent to it being shown to such Futures and Options Association members' affiliates (being members of such persons' groups, as defined by~~ to whom disclosure is required to be made by applicable law or court order or pursuant to the ~~UK Financial Services and Markets Act 2000) and to~~ rules or regulations of any supervisory or regulatory body or in connection with any judicial proceedings; and

(C) any competent authority supervising a subscribing member or its affiliates,

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 but not for the purposes of reliance, and (ii) we do not assume any duty or liability to any person to whom such ~~member firms~~disclosure is made and ~~their affiliates in connection with~~ in preparing this opinion we have not had regard to the interests of any such person.

This opinion was prepared by us on the basis of instructions from FIA Europe in the context of the netting requirements of the Basel III capital rules in the EU and US and we have not taken instructions from, and this opinion does not take account of the specific circumstances of, any subscribing member. In preparing this opinion, we had no regard to any other purpose to which this opinion may be put by any subscribing member.

By permitting subscribing members to rely on this opinion as stated above, we accept responsibility to such subscribing members for the matters specifically opined upon in this opinion in the context stated in the preceding paragraph, but we do not have or assume any client relationship in connection therewith or assume any wider duty to any subscribing member or their ~~compliance with their obligations under prudential regulation~~affiliates. This opinion has not been prepared in connection with, and is not intended for use in, any specific transaction.

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Furthermore this opinion is given on the basis that any limitation on the liability of any other adviser to FIA Europe or any subscribing member, whether or not we are aware of that limitation, will not adversely affect our position in any circumstances.

Yours faithfully,

Studio Legale Associato
in Associazione con Clifford Chance

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Annex 1: Form of Clearing Agreement