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EFMLG

Article 194 CRR : legal opinions for credit risks mitigation techniques

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Reminder of the new requirements

Article 194: Reminder of the new requirements

- **The duty to provide a legal opinion for credit risk protections received**
 - ✓ European Regulation n° 575/2013 « CRR » dated 26th June 2013, included in the « Capital Requirement Directive IV package », relating to prudential requirements, and which shall enter into force on 1st January 2014 requires credit institutions to be able to provide the supervisor with a legal opinion to support the use of a credit protection accepted to mitigate credit risk as part of capital requirement calculation.
 - ✓ It should be noted that under the previous regime (CRD) when the CRR regulation came into force, the credit protection received were required to be subject to a legal check of their effectiveness and their enforceability, but provision of a formal legal opinion was not a requirement.



Meeting with the French ACPR (legal department)

Article 194: meeting with the ACPR

- **General approach :**

- ✓ Great caution from the ACPR which insists on the novelty of the text.
- ✓ In the next coming months, supervision and regulatory / enforceability powers will be transferred to the ECB for important institutions. It seems obvious that the positions taken by the ECB will prevail even for less important credit institutions, which will remain under the supervision of national supervisors.
- ✓ The interpretation of the text (CRD/CRR) belongs to the EBA and the European Commission (under the control of the CJEU).
- ✓ The second new element: the European text is now a regulation directly applicable in the different members States's law, while in the previous regime, it was a directive leaving some flexibility to national regulators. Under the previous directive, the ACPR had not defined precisely the concept of mitigation technique "legally effective and enforceable".

Article 194: meeting with the ACPR

▪ The notion of independency

- ✓ The ACPR has some reservations on the possibility for in-house lawyers to issue legal opinions.
- ✓ It refers to the jurisprudence of the CJEU on legal privilege and concludes that an lawyer who is an employee of the bank is in a relationship of subordination which is not compatible with the independency required to deliver legal opinions.
- ✓ Nevertheless, the ACPR acknowledges that the EBA recognizes the possibility of internal legal opinions but considers that, at the minimum, the in-house lawyer should have a specific status (like in Belgium).
- ✓ In the end, as a ultimate position, the ACPR considers that, should an in-house legal opinion be accepted, it should be issued by a person not involved in the operation.
- ✓ However, the ACPR has referred, several times, to the fact that the ECB relies on internal legal opinion for the purpose of accepting collateral in the Eurosystem.

Article 194: meeting with the ACPR

▪ The nature of the opinion

- ✓ The ACPR agrees on the possibility to distinguish between plain vanilla, repetitive and domestic operations, for which a generic opinion should be admitted and more structured / cross border operations for which an ad hoc opinion is necessary. The ACPR has some doubts on the necessity to have legal opinions for the first category when the operations are clearly regulated.
- ✓ The ACPR confirms that the article 194 requirement does not cover capacity opinions.
- ✓ Its position on bankruptcy qualifications was not clear.

▪ The stock

- ✓ The ACPR considers that the new rule should apply to transactions concluded before the 1st of January 2014. But a soft application of the regime could be envisaged.

▪ In conclusion

- ✓ The ACPR calls for the utmost prudence on the positions that could be taken by the new supervisor.
- ✓ The issue could be raised very soon in the context of the AQR, even though – at this stage – the sole question of the value of the reviewed assets was raised.

Article 194: possible approach

- **Taking into account the elements resulting from the ACPR meeting, the following approach could be considered by the Industry :**
 - ✓ To define the scope of guarantees for which a generic opinion must be obtained, and the scope of those needing ad hoc opinions,
 - ✓ To define the different possibilities of obtaining in house opinions.
 - ✓ The FBF is working on a French Industry's project memo.

- **Parallely, the issue has been raised at the EBF level, in order to know the solutions considered in other jurisdictions and to prepare a common position via-à-vis the EBA and the ECB**



Draft position on the application of these new requirements

Article 194: proposal

- **Standard guarantee deeds may be the subject of a generic legal opinion**
- ✓ When the subject entity enters into transactions of a similar nature, subject to the law of a single country and using identical Credit Protection Arrangement (APR) techniques, it may rely upon generic legal opinions. In such a case, it is not required to obtain a new legal opinion for each transaction.
- ✓ In order to benefit from the comfort brought by the generic legal opinion, the standard guarantee deed must not be altered or modified significantly, in a way that would undermine its effects and the protection. In this respect, any modification of this type should be assessed by a lawyer, either in-house or external. The traceability of this involvement should be ensured.

Article 194: proposal

Therefore, the following standard guarantee deeds may, inter alia, be the subject of generic legal opinions:

- ✓ Mortgage on immovable property;
- ✓ Special real estate privilege;
- ✓ Mortgage on movable properties (seagoing ships, river boats, aircrafts);
- ✓ Security interest, whether possessory or not possessory;
- ✓ Collateral (full ownership transfer or pledge);
- ✓ Pledge of intangible assets;
- ✓ Assignment of claim under the “Daily” law ;
- ✓ Cash pledge;
- ✓ Fiduciary – guarantee;
- ✓ Export credit guarantee (Coface, Hermes...);
- ✓ CDS.

Article 194: proposal

- **Non-standard deeds must be the subject of an *ad hoc* legal opinion.**

- **In the following cases (non comprehensive list), the subject entity must obtain an *ad hoc* formal legal opinion:**
 - ✓ CPA deed which is specific and non-standard or includes features which are different from those for which the entity holds a generic legal opinion ;
 - ✓ CPA deed not provided by the subject entity, i.e. by the client, its counsel, by an entity taking part in the transaction or by a legal advisor involved in the transaction;
 - ✓ CPA originating from a country which is covered by the legal opinions previously obtained (e.g. mortgage on a property located in a country for which the subject entity does not hold a legal opinion, etc.).

Article 194: proposal

- **Form of the legal opinion**

- **Legal opinion provided by a law firm**

- ✓ When a law firm is involved in a transaction to which the subject entity is a party and that the former produces or contributes towards the legal documentation and the provision of various usual legal opinions (capacity, etc.), it may also be requested to provide a legal opinion of the effective and enforceable nature of CPAs received by the subject entity (or by the group of participating banks, in the case for example, of a syndicated loan).

- **Legal opinion provided internally**

- ✓ In the FAQs dated 4th July 2013 referred to above, the EBA allows legal opinions to be produced internally, as long as they are produced in an independent manner, in writing, and justified, which seems to be authorised by the text.
- ✓ The question of the independency of an in-house lawyer must be analysed with regard to the internal organisation of credit institutions. This independency should be characterised enough as soon as the in-house lawyer who issues the legal opinion belongs to a central legal department, independent from the business line having originated the operation.