Single Rulebook Q&A

Question ID	2013_23
Status	Final Q&A
Legal act	Regulation (EU) No 575/2013 (CRR)
Topic	Credit risk
Article	194
Paragraph	(1)
Subparagraph	-
COM Delegated or Implementing Acts/RTS/ITS/GLs/Recommendations	Not applicable
Article/Paragraph	N/A
Date of submission	04/07/2013
Disclose name of institution / entity	No
Type of submitter	Law firm
Subject matter	Credit risk mitigation techniques - independent, written and reasoned legal opinions
Question	Must lending institutions always obtain a written reasoned legal opinion in order to rely on their credit protection techniques for the purposes of Article 194(1) of the CRR? If so : a) must such opinion be obtained from external legal counsel? b) must such opinion be specific to the relevant transaction and techniques in respect of which the institution seeks to rely upon such opinion, or can lending institutions rely on generic opinions for particular types of transactions? If the latter, how often should the generic opinions be updated?
Background on the	The first sub paragraph of Article 194(1) and Article 194(2) CRR are

question	identical to Articles 92(1) and 92(2) respectively of Directive 2006/48/EC, which require institutions to take non-prescribed due diligence steps to ensure that their credit risk mitigation protections are effective in order to rely on them for regulatory capital purposes. Except for certain mitigation techniques, institutions have not typically obtained formal legal opinions from external counsel in this regard but have relied upon a broad range of measures (e.g. internal legal review, opinions on analogous scenarios, individual experience, market practice). Articles 194(1) and (2) CRR do not introduce an explicit requirement for firms to obtain written reasoned legal opinions, nor are we aware of any grounds inBasel III for such a requirement. However, the second sub-paragraph of Article 194(1) provides that: "the lending institution shall provide, upon request of the competent authority, the most recent version of the independent, written and reasoned legal opinion or opinions that is used to establish whether its credit protection arrangement or arrangements meet the condition laid down in the first sub-paragraph". Read literally, such sub-paragraph does not state that institutions must obtain an independent written and reasoned legal opinion in order to establish the condition in Article 194(1), but can be read as meaning that if an institution had obtained such an opinion, then it must provide it if requested. However, on an alternative reading might imply that an institution must obtain such a legal opinion in order to establish the condition in the first sub-paragraph of Article 194(1). In any event it is ambiguous a) whether such opinion must be obtained from external legal counsel and b) whether an institution must obtain a new opinion for every transaction, or whether it can rely upon opinions obtained in respect of similar/analogous structures. If the alternative reading is correct, then institutions would be unable to rely their existing - and future - credit risk mitigation techniques unless they obtain new legal opinions from external counsel. Implications include: a) significant expenses and delays in obtaining legal opinions in respect of existing and future arrangements b) sudden increase in capital requirements - as exposures previously benefiting from credit protection techniques would lose such benefits, absent legal opinions.
EBA answer	Article 194(1) of the Regulation (EU) 575/2013 requires that credit protection is legally effective and enforceable in all relevant jurisdictions. This condition must be met before the credit protection can be considered as an eligible credit risk mitigation technique. The only way for an institution to establish whether this condition is met is to obtain a legal opinion. The requirement in the abovementioned Article does not specify that such opinion needs to be obtained from an external legal counsel. As long as it is “independent, written and reasoned” it may also be provided by an internal legal counsel. On the issue of whether an opinion must be specific to the relevant transaction covered and the technique employed by the institution or whether it can be a generic one, it depends mainly on the nature of the two.

	If an institution engages in the same type of transaction, with counterparties located in the same jurisdiction and uses the same credit risk mitigation technique, then it can rely on the same opinion. For example, if an institution uses a master netting agreement for which a generic opinion exists, it can use that opinion as long as the latter clearly indicates that the agreement is legally effective and enforceable in all the jurisdictions relevant to the transactions covered by that agreement. DISCLAIMER: This question goes beyond matters of consistent and effective application of the regulatory framework. A Directorate–General of the Commission (Directorate General for Internal Market and Services) has prepared the answer, albeit that only the Court of Justice of the European Union can provide definitive interpretations of EU legislation. This is an unofficial opinion of that Directorate General, which the European Banking Authority publishes on its behalf. The answers are not binding on the European Commission as an institution. You should be aware that the European Commission could adopt a position different from the one expressed in such Q&As, for instance in infringement proceedings or after a detailed examination of a specific case or on the basis of any new legal or factual elements that may have been brought to its attention.
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