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## **TORONTO OPINIONS GROUP Summary of Discussion at the December 12, 2012 Meeting of TOROG on ISDA Opinion Practice**

### ***Background***

There are a variety of transactions that use ISDA documentation. As explained on the [ISDA](#) website:

ISDA's pioneering work in developing the ISDA Master Agreement and a wide range of related documentation materials, and in ensuring the enforceability of their netting and collateral provisions, has helped to significantly reduce credit and legal risk. The Association has been a leader in promoting sound risk management practices and processes, and engages constructively with policymakers and legislators around the world to advance the understanding and treatment of derivatives as a risk management tool.

Today, the Association has over 840 members from 59 countries on six continents. These members include a broad range of OTC derivatives market participants: global, international and regional banks, asset managers, energy and commodities firms, government and supranational entities, insurers and diversified financial institutions, corporations, law firms, exchanges, clearinghouses and other service providers.

ISDA's work in three key areas – reducing counterparty credit risk, increasing transparency, and improving the industry's operational infrastructure – show the strong commitment of the Association toward its primary goals; to build robust, stable financial markets and a strong financial regulatory framework.

[\(http://www2.isda.org/about-isda/\)](http://www2.isda.org/about-isda/)

For transaction lawyers, the ISDA Master Agreement (including the Schedule and in many cases a Credit Support Annex) is of importance:

The ISDA Master Agreement, the authoritative contract widely used by industry participants, represents a milestone achievement because it has established international contractual standards governing privately negotiated derivatives transactions that reduce legal uncertainty and allow for reduction of credit risk through netting of contractual obligations. Ensuring the enforceability of the netting provisions of the ISDA Master Agreement has been, and remains, a key initiative, because of its importance in reducing the credit risk arising from the business.

The scope of the ISDA opinions address the enforceability of the termination, bilateral close-out netting and multibranch netting provisions of the 1992 and 2002 Master Agreements. The opinions are updated annually to comply with requests from various central banks. In addition, ISDA also solicits legal opinions on the enforceability of the ISDA Credit Support Documents in various jurisdictions. Those opinions are also updated on an annual basis and are available to members on this website. (<http://www2.isda.org/functional-areas/legal-and-documentation/opinions/>)

The issue discussed at the meeting was whether Toronto opinion lawyers, other than those whose practices focus on ISDA governed documentation, should resist giving enforceability opinions on ISDA documentation except in very unusual circumstances.

### *The Discussion*

A wide range of views were expressed on the role of opinions in ISDA transactions, starting with the view that opinions should not be required on any transaction, including transactions with an ISDA component.

After some discussion, the following types of transactions and opinions were identified:

- the “usual” corporate opinions that lead up to the ISDA transaction
- enforceability opinions on the ISDA Master Agreement (including the Schedule and the credit support annex (CSA))
- enforceability opinions on the Transaction Confirmations
- post-insolvency opinions on ISDA agreements

### *The “usual” corporate opinions that lead up to the ISDA transaction*

There seemed to be general consensus that it would be appropriate to ask for and give the “usual” corporate opinions (power, authority and due authorization opinions) on ISDA documentation (this would include the Master Agreement, Schedule and CSA, and the Transaction Confirmation).

### *Enforceability opinions on the ISDA Master Agreement (including the Schedule and the CSA)*

The following points were made during the discussion on this point:

- banks require opinions on ISDA transactions for regulatory capital purposes
- the ISDA industry opinion (on which ISDA members can rely) is not a “standard enforceability opinion” as it does not address enforceability as a whole – it addresses enforceability of specific terms only (namely the termination rights and right to net transaction values on various events of default, both pre and post insolvency) and the validity, perfection and priority of the security interests granted under the CSA)
- some firms advised that they had been successful in resisting requests for enforceability opinions; others had not
- there was concern expressed that some lawyers might not be aware that it was possible to resist giving ISDA opinions in some circumstances (eg if the lender was viewing the ISDA opinion as merely a “tick the box” requirement (in which case it might be necessary to escalate the issue to explain why the opinion does not add much value)
- with structured deals (example of fund forward deal), an enforceability opinion is important because this is the essence of the transaction
- it was noted that financial institutions often have in-house ISDA experts who may be in a position to advise the financial institution on whether an opinion is really necessary
- at first glance, ISDA contracts can appear to be deceptively simple in their language
- it can take a significant time investment for a lawyer to understand ISDA documentation if the lawyer does not have a lot of experience with this type of work
- while it was generally agreed that lawyers from smaller jurisdictions would likely have more issues dealing with ISDA documentation, there were differing views on expectations for “Toronto lawyers” – some expressed the view that only a relatively small number of lawyers do this work (ie not all banking lawyers doing reasonably sophisticated banking work do ISDA work) with some firms indicating they might only see 2-3 ISDA transactions in a year
- whether or not it is appropriate for a lawyer to give an ISDA opinion does require an examination of level of expertise, time and cost
- ISDA documents are not harder to understand than any complex credit agreement
- the Master Agreement itself is not that complex as it is just a set of general terms – the governing law of the Master Agreement is New York law, but the terms of the Schedule can change the applicable law
- the concern may be that there is something specific about the counterparty that may affect enforceability
- there may be issues buried in the authorization/power opinion
- Interest Rate Swaps do incorporate some defined terms from the ISDA Definitions Documents (which are available to ISDA members or can be purchased from [ISDA](#))
- the same arguments that are raised by borrower’s counsel asked to opine on bank standard form loan documents can also be made in respect of the preprinted ISDA Master Agreement
- recent decisions on ISDA transaction documents are in substance decisions about interpretation rather than enforceability (aside from insolvency issues)

*Enforceability opinions on the Transaction Confirmations*

The following points were made during the discussion on this point:

- banks often accept an enforceability opinion on the Master Agreement and Schedule and don't require an opinion on the Confirmation
- in more structured deals or if the transaction is an interest rate swap associated with a loan for example, counsel could be asked to opine on the Transaction Confirmation (this does require more expertise)
- when opining on a Transaction Confirmation, it is appropriate to include an assumption that the terms of the trade as reflected in the Confirmation reflect the agreement and understanding of the parties (there are usually formulas and economic provisions in the confirmation that are not appropriate subject matter for a legal opinion)
- there were differing views expressed on "plain vanilla" interest rate swap Confirmations – to the extent these are relatively straightforward, this is either an argument for or against giving an enforceability opinion

#### *Post-insolvency opinions on ISDA agreements*

The following points were made during the discussion on this point:

- no one in a transaction context should be asked for post-insolvency opinions on ISDA agreements
- insolvency opinions always require insolvency expertise
- ISDA members can rely on the industry ISDA opinions where it covers their circumstances or obtain a supplement from experienced counsel who are also ISDA members where it does not

#### *Summarizing the Discussion*

Those at the meeting attempted to summarize the discussion. There appeared to be agreement on the following points:

- it is generally appropriate to ask for and give the "usual" corporate opinions (power, authority and due authorization opinions) on ISDA documentation (this would include the Master Agreement, Schedule and CSA, and the Transaction Confirmation)
- there may be more important issues to negotiate than who should give an ISDA enforceability opinion
- each firm must decide for itself if it has the expertise to give ISDA enforceability opinions
- it is relevant to raise the issue of the time and money required to give an ISDA opinion
- ISDA expertise tends to be in-house so bank counsel are probably more comfortable about relying on the ISDA industry opinion
- it will still be a matter of negotiation as to whether any firm should give an opinion (having regard to the fact that there is an ISDA industry opinion that ISDA members can look to)
- enforceability opinions on Transaction Confirmations should not generally be requested or given by the counterparty's counsel except for certain types of structured transactions where the confirmation is the essence of the transaction or counsel has the requisite expertise

- while the Master Agreement is self-contained, the Schedule does refer to definitions described in ISDA documentation – if that documentation is not going to be reviewed, assumptions or carve-outs could be used to limit the opinion
- there was interest in trying to standardize the “economic terms” qualification that should be included if an opinion is given on a Transaction Confirmation