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Commission Delegated Regulation (EU) 2016/1401 of 23 May 2016 supplementing Directive 2014/59/EU of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms with regard to regulatory technical standards for methodologies and principles on the valuation of liabilities arising from derivatives (Text with EEA relevance)

Article 1

Definitions

For the purposes of this Regulation, the following definitions shall apply:

- (1) 'netting set' means a group of contracts subject to a netting arrangement as defined in Article 2(1)(98) of Directive 2014/59/EU;
- (2) 'valuer' means the independent expert appointed to carry out the valuation in compliance with the requirements and the criteria set out in Part Four of Commission Delegated Regulation (EU) 2016/1075⁽¹⁾ or the resolution authority when conducting the valuation pursuant to paragraphs (2) and (9) of Article 36 of Directive 2014/59/EU;
- (3) 'central counterparty', or 'CCP', means a CCP as defined in Article 2(1) of Regulation (EU) No 648/2012, to the extent that it is either:
 - (a) established in the Union and authorised in accordance with the procedure set out in Articles 14 to 21 of Regulation (EU) No 648/2012;
 - (b) established in a third country and recognised in accordance with the procedure set out in Article 25 of Regulation (EU) No 648/2012;
- (4) 'clearing member' means a clearing member as defined in Article 2(14) of Regulation (EU) No 648/2012;
- (5) 'close-out date' means the day and time of the close-out specified in the communication by the resolution authority of the decision to close-out;
- (6) 'replacement trade' means a transaction entered into on or after the close-out date of a derivative contract to re-establish, on a net risk exposure basis, any hedge or related trading position that has been terminated on equivalent economic terms as the closed-out transaction;
- (7) 'commercially reasonable replacement trade' means a replacement trade entered into on a netted risk exposure basis, on terms consistent with common market practice and by making reasonable efforts to obtain best value for money.

Article 2

Comparison between the destruction in value that would arise from the close-out and the bail-in potential of derivative contracts

1 For the purpose of Article 49(4)(c) of Directive 2014/59/EU, the resolution authority shall compare the following:

- a the amount of losses that would be borne by the derivative contracts in a bail-in, obtained by multiplying:

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- (i) the share, within all equally ranked liabilities, of liabilities arising from the derivative contracts determined as part of the valuation under Article 36 of Directive 2014/59/EU and not falling within the exclusions from bail-in pursuant to Article 44(2) of that Directive; by
 - (ii) the total losses expected to be borne by all liabilities ranking equally to derivatives, including the derivative liabilities stemming from the close-out;
- with
- b the destruction in value based on an assessment of the amount of the costs, expenses, or other impairment in value that is expected to be incurred as a result of the close-out of the derivative contracts, and obtained by calculating the sum of the following elements:
 - (i) the risk of an increased counterparty close-out claim arising from re-hedging costs expected to be incurred by the counterparty, by taking into account the bid-offer, mid-to-bid or mid-to-offer spreads in line with Article 6(2)(b);
 - (ii) the cost expected to be incurred by the institution under resolution in establishing any comparable derivative trades considered necessary in order to re-establish a hedge for any open exposure or in order to maintain an acceptable risk profile in line with the resolution strategy. The establishment of a comparable derivative trade may be achieved by taking into consideration initial margin requirements and prevailing bid-offer spreads;
 - (iii) any reduction to franchise value arising from the close-out of derivative contracts, including any valuation impairment for other or underlying assets that are linked to the derivative contracts being closed out, and any impact on funding costs or income levels;
 - (iv) any precautionary buffer against possible adverse implications from close-out, such as errors and disputes in respect of transactions or collateral exchange.

2 The comparison under paragraph 1 shall be made before a decision to close-out is taken, as part of the valuation to inform decisions about resolution actions required under Article 36 of Directive 2014/59/EU. Once a delegated act adopted by the Commission pursuant to Article 36(15) of that Directive enters into force, the comparison shall follow the requirements set out in that delegated act.

Article 3

Communication of the decision to close out

1 Prior to exercising the write-down and conversion powers in relation to liabilities arising from derivative contracts, the resolution authority shall communicate the decision to close out contracts pursuant to Article 63(1)(k) of Directive 2014/59/EU to the counterparties to those contracts.

2 The decision to close out shall take effect immediately, or at a later close-out date and time as specified in the communication.

3 In the decision referred to in paragraph 1, the resolution authority shall specify a date and time, taking account of the requirements in Article 8(1)(c), by which counterparties may provide evidence to the resolution authority of commercially reasonable replacement trades for the purpose of determining the close-out amount pursuant to Article 6(1). The counterparty shall

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4 The resolution authority may change the date and time by which counterparties may provide evidence of commercially reasonable replacement trades where such change is consistent with Article 8(1)(c).

Any decision to change the date and time by which counterparties may provide evidence of commercially reasonable replacement trades shall be communicated to the counterparty.

5 In the decision referred to in paragraph 1, the resolution authority may specify the criteria it intends to apply when assessing whether replacement trades are commercially reasonable.

6 This Article shall not apply to the close-out and valuation of centrally cleared derivative contracts entered into between the institution under resolution, acting as a clearing member, and a CCP.

Article 4

Role of the netting agreement

For contracts subject to a netting agreement, the valuer shall determine, in accordance with Articles 2, 5, 6, and 7, a single amount which the institution under resolution has the legal right to receive or the legal obligation to pay as a result of the close-out of all the derivative contracts in the netting set, as defined in the netting agreement.

Article 5

Valuation principle for early termination amount

1 The valuer shall determine the value of liabilities arising from derivative contracts as an early termination amount calculated as the sum of the following amounts:

- a unpaid amounts, collateral or other amounts due from the institution under resolution to the counterparty, less unpaid amounts, collateral and other amounts due from the counterparty to the institution under resolution on the close-out date;
- b a close-out amount covering the amount of losses or costs incurred by derivative counterparties, or gains realised by them, by replacing or obtaining the economic equivalent of material terms of the terminated contracts and the option rights of the parties in respect of those contracts.

2 For purposes of paragraph 1, unpaid amounts means, in respect of closed-out derivative contracts, the sum of the following:

- a amounts that became payable on or prior to the close-out date and which remain unpaid on that date;
- b an amount equal to the fair market value of the asset which was required to be delivered for each obligation of the derivative contracts which was required to be settled by delivery on or prior to the close-out date and which has not been settled as at the close-out date;
- c amounts in respect of interest or compensation accrued during the period from the date on which relevant payment or delivery obligations fell due through to the close-out date.

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Article 6

Determination of the close-out amount

1 Where a counterparty has provided evidence of commercially reasonable replacement trades within the deadline set out in Article 3(3), the valuer shall determine the close-out amount at the prices of those replacement trades.

2 Where a counterparty has not provided evidence of any replacement trades within the deadline set out in Article 3(3), where the valuer concludes that the communicated replacement trades were not concluded on commercially reasonable terms, or where Articles 7(7) or 8(2) apply, the valuer shall determine the close-out amount on the basis of the following:

- a the mid-market end-of-day prices in line with the business-as-usual processes within the institution under resolution at the date determined pursuant to Article 8;
- b the mid-to-bid spread or mid-to-offer spread, depending on the direction of the netted risk position;
- c adjustments to the prices and spreads mentioned in points (a) and (b) where necessary to reflect the liquidity of the market for the underlying risks or instruments and the size of the exposure relative to market depth, as well as possible model risk.

3 With regard to intra-group liabilities, the valuer may establish the value at mid-market end-of-day prices as referred to in paragraph 2(a), without regard to paragraph 2(b) and 2(c), where the resolution strategy would imply re-hedging the terminated transactions via another intra-group derivative transaction or group of transactions.

4 For determining a value of the close-out amount pursuant to paragraph 2, the valuer shall consider a full range of available and reliable data sources and may rely on observable market data or theoretical prices generated by valuation models aimed at estimating values, including the following sources of data:

- a data provided by third parties, such as observable market data or valuation parameters data and quotes from market-makers or, where a contract is centrally cleared, values or estimates obtained from CCPs;
- b for standardised products, valuations generated by the valuer's own systems;
- c data available within the institution under resolution, such as internal models and valuations including independent price verifications performed pursuant to Article 105(8) of Regulation (EU) No 575/2013 of the European Parliament and of the Council⁽²⁾;
- d data provided by counterparties other than evidence of replacement trades communicated pursuant to Article 3(3), including data on current or previous valuation disputes with regard to similar or related transactions and quotes;
- e any other relevant data.

5 For the purpose of paragraph 2(b), the resolution authority may instruct the institution under resolution to perform an updated independent price verification as at the reference point in time determined pursuant to Article 8, using end-of-day information available on the close-out date.

6 This Article shall not apply to the determination of a close-out amount for cleared derivative contracts entered into between an institution under resolution and a CCP, except in the exceptional circumstances set out in Article 7(7).

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Article 7

Valuation of cleared derivative contracts entered into between an institution under resolution and a CCP

1 The valuer shall establish the value of liabilities arising from derivative contracts entered between, on the one hand, an institution under resolution acting as a clearing member and, on the other hand, a CCP, based on the valuation principle specified in Article 5. The early termination amount shall be determined by the CCP, within the deadline specified in paragraph 5, in accordance with the CCP default procedures, after deducting the collateral provided by the institution under resolution including initial margin, variation margin and contributions of the institution under resolution to the default fund of the CCP.

2 The resolution authority shall communicate to the CCP and the CCP's competent authority its decision to close out the derivative contracts pursuant to Article 63(1)(k) of Directive 2014/59/EU. The decision to close out shall take effect immediately, or on the date and time specified in the communication.

3 The resolution authority shall instruct the CCP to provide its valuation of the early termination amount for all the derivative contracts in the relevant netting set, in accordance with the CCP default procedure.

4 The CCP shall provide the resolution authority with the CCP default procedure documents and shall report the default management steps undertaken.

5 The resolution authority shall, in agreement with the CCP and the CCP's competent authority, set the deadline by which the CCP must provide the valuation of the early termination amount. For that purpose, the resolution authority, the CCP and the CCP's competent authority shall take both of the following into account:

- a the default procedure, as established by the CCP governance rules in compliance with Article 48 of Regulation (EU) No 648/2012;
- b the resolution timeline.

6 The resolution authority may change the deadline set under paragraph 5 upon agreement with the CCP and the CCP's competent authority.

7 By derogation to paragraph 1, the resolution authority may decide to apply the methodology laid down in Article 6, after consulting the CCP's competent authority, in either of the following cases:

- a the CCP does not provide the valuation of the early termination amount within the deadline set by the resolution authority pursuant to paragraph 5; or
- b the CCP's valuation of the early termination amount is not in line with the CCP default procedures set out in Article 48 of Regulation (EU) No 648/2012.

Article 8

Point in time for establishing the value of derivative liabilities and early determination

1 The valuer shall determine the value of derivative liabilities at the following point in time:

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- a where the valuer determines the early termination amount at the prices of replacement trades pursuant to Article 6(1), the day and time of the conclusion of the replacement trades;
- b where the valuer determines the early termination amount in accordance with the CCP default procedures pursuant to Article 7(1), the day and time when the early termination amount has been determined by the CCP;
- c in all other cases, the close-out date or, where that would not be commercially reasonable, the day and time at which a market price is available for the underlying asset.

2 The valuer may, as part of a provisional valuation carried out pursuant to Article 36(9) of Directive 2014/59/EU, determine the value of liabilities arising from derivatives earlier than at the point in time determined pursuant to paragraph 1. Such early determination shall be made on the basis of estimates, relying on the principles laid down in Article 5 and Article 6(2) to (5), and on data available at the time of the determination.

3 Where the valuer carries out an early determination pursuant to paragraph 2, the resolution authority may at any time request the valuer to update the provisional valuation to take into account relevant observable market developments or evidence of commercially reasonable replacement trades concluded at the point in time determined pursuant to paragraph 1. These developments or evidence, where available by the date and time specified pursuant to Article 3(2), shall be taken into account in the *ex post* definitive valuation carried out pursuant to Article 36(10) of Directive 2014/59/EU.

4 Where the valuer carries out an early determination pursuant to paragraph 2 in relation to derivative contracts entered into between an institution under resolution acting as a clearing member and a CCP, the valuer shall take due account of any estimate of expected close-out costs provided by the CCP.

Where the CCP provides a valuation of the early termination amount in accordance with the CCP default procedures by the deadline set pursuant to Article 7(5) and (6), that valuation shall be taken into account in the *ex post* definitive valuation carried out pursuant to Article 36(10) of Directive 2014/59/EU.

Article 9

Entry into force

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels, 23 May 2016.

For the Commission

The President

Jean-Claude JUNCKER

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- (1) Commission Delegated Regulation (EU) 2016/1075 of 23 March 2016 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the content of recovery plans, resolution plans and group resolution plans, the minimum criteria that the competent authority is to assess as regards recovery plans and group recovery plans, the conditions for group financial support, the requirements for independent valuers, the contractual recognition of write-down and conversion powers, the procedures and contents of notification requirements and of notice of suspension and the operational functioning of the resolution colleges (OJ L 184, 8.7.2016, p. 1).
- (2) Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1).

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