

Norma 11/28-ian-2016 NORM no. 11 of 28 January 2016 on the methodology used to determine the value of derivatives when an insurer is in the resolution process (traducere)

Norma 11/28-ian-2016 din 2016.02.08

Status: Acte în vigoare

Versiune de la: 8 Februarie 2016

Intră în vigoare:

8 Februarie 2016 An

Norma 11/28-ian-2016 (traducere) NORM no. 11 of 28 January 2016 on the methodology used to determine the value of derivatives when an insurer is in the resolution process (traducere)

Data act: 28-ian-2016

Emitent: Autoritatea de Supraveghere Financiara

In accordance with the provisions of Article 1(2), Article 2(1)(a), (b) and (d), Article 3(1)(b), Article 6(2) and Article 14 of the Government Emergency Ordinance no. 93/2012 on the establishment, organization and functioning of the Financial Supervisory Authority, approved with amendments and completions by Law no. 113/2013, as subsequently amended and supplemented,

Pursuant to the provisions of Article 160 letter i) of Law no. 246/2015 on the recovery and resolution of insurers,

following the deliberations of the Board meeting of the Financial Supervisory Authority on 27 January 2016,

The Financial Supervisory Authority issues the following rule.

CHAPTER I: Subject-matter, scope and definitions

Article 1

(1) This rule governs the methodology used to determine the value of derivatives when an insurer is in the resolution process.

(2) This rule shall apply:

- a) insurers subject to resolution;
- b) financial auditors;
- c) relevant counterparties.

Article 2

(1) The terms and expressions used in this rule have the meanings provided by:

- a) Article 2 of Law no. 246/2015 on the recovery and resolution of insurers;
- b) Article 2 of Law no. 297/2004 on the capital market, with subsequent amendments and completions, as well as the regulations in its application;
- c) Article 1 paragraph (2) of Law no. 237/2015 regarding the authorization and supervision of the insurance and reinsurance activity.

(2) Also, the terms below have the following meanings:

1. financial auditor – the financial auditor provided for in Article 55 of Law no. 246/2015;
2. competent authority – the authority referred to in Article 2(13) of 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;
3. derivative financial contract – the derivative financial instrument provided for in Article 2(1)(12) of Law no. 297/2004, as subsequently amended and supplemented;
4. relevant counterparty – an entity that is a party to a derivative financial contract with a resolution insurer, including a central counterparty referred to in Article 2(1) of Regulation (EU) No 648/2012;
5. reasonable substitution – a replacement transaction concluded under conditions in accordance with current market practices and for which every effort is made to obtain the most advantageous commercial conditions at the time of its conclusion;
6. early termination - the termination of the validity of a derivative financial contract before its maturity date or expiration date;
7. clearing set – a group of transactions between an institution and a single counterparty that is the subject of a legally enforceable bilateral clearing arrangement;
8. replacement transactions – a transaction with a derivative that generates economic conditions and exposures equivalent to a derivative financial contract on which early termination has been decided.

CHAPTER II: Early termination of derivative contracts

SECTION 1: General considerations

Article 3

(1) The Financial Supervisory Authority, hereinafter referred to as the FSA, as the resolution authority, exercises its powers to write down or convert in relation to a liability of the insurer subject to resolution arising from a derivative only at the time of maturity or after the early termination of the derivative financial contracts.

(2) Upon entering the resolution procedure, the FSA, as the resolution authority, may terminate early any derivative financial contract concluded by an insurer subject to resolution.

Article 4

(1) Before exercising the power to write down or convert debts into equity instruments, the FSA, as the resolution authority, shall notify the decision to terminate the derivative financial contracts early to all counterparties to the derivative financial contracts of the insurer under resolution.

(2) The decision to terminate derivatives early may be applied immediately or at a date subsequent to the submission of the notification referred to in paragraph 1.

(3) In the decision referred to in paragraph 1, the FSA, as resolution authority, shall specify the date and time at which the requirements of Article 7(1) are to be met, whereby counterparties to derivative financial contracts provide evidence of commercial transactions in which the reasonable replacement of derivative financial contracts subject to early termination is carried out.

(4) Each relevant counterparty shall provide the FSA with a summary of all replacement transactions, and the FSA shall transmit to the financial auditor the information received from the relevant counterparties.

SECTION 2: Benchmarking

Article 5

(1) The financial auditor must make the following comparisons:

a) the value of the losses that would be generated by the derivative financial contracts, obtained by multiplying:

1. (i) the share of the obligations arising from the derivative financial contracts, from all obligations of the same rank;
2. (ii) total losses expected to be incurred by all liabilities of equal standing in derivative financial contracts, including liabilities arising from early termination of derivative financial contracts,

b) the amount of impairments/losses calculated on the basis of the valuation of costs, expenses or other impairments/losses expected to be recorded as a result of early termination of derivative financial contracts, obtained by summing up the following items:

1. (i) the risk of an increase in the counterparty's termination claims, claims arising from the costs of the re-hedging transactions estimated to be borne by the contractual partner, taking into account the difference between the prices of the best bid and the bids to sell in accordance with the provisions of Article 7(2)(b);
2. (ii) the costs expected to be incurred by the resolution insurer in identifying any derivative transactions deemed necessary in order to restore hedging any open position or to maintain an acceptable risk profile in accordance with the resolution strategy. This can be achieved by taking into account the initial margin requirements and the difference between the prices of the best bids and offers to sell for derivative financial contracts;
3. (iii) any reduction in the value of rights resulting from the early termination of derivative financial contracts, including any impairment/decrease in value resulting from valuations of underlying assets or other assets, which are linked to derivative financial contracts, which are terminated and any impact on financing costs or income levels;
4. (iv) any other additional amounts against possible adverse effects resulting from early termination, such as errors or disputes relating to transactions or in relation to the return of guarantees.

(2) The comparisons referred to in paragraph 1 shall be made prior to the taking of any early termination decision as part of the assessment to substantiate the decisions on resolution measures.

CHAPTER III: Early termination value

SECTION 1: General considerations

Article 6

The financial auditor shall determine the amount of obligations arising from derivative financial contracts under a netting set as an early termination value calculated as the sum between:

- a) unpaid amounts, guarantees or other amounts owed by the resolution insurer to the relevant counterparty, less unpaid amounts, guarantees and other amounts owed by that relevant counterparty to the resolution insurer on the date of termination of the derivative financial contracts; and
- b) amounts to cover the amount of losses or expenses incurred by the relevant counterparty or the gains made by the relevant counterparty from the replacement of derivative financial contracts or

from obtaining equivalent economic advantages due to the materialisation of the terms of the derivative financial contracts and the rights related to the parties' option in relation to the termination of the contracts.

Article 7

(1) Where the relevant counterparty has provided relevant information, within the time limit set in accordance with Article 4(3), relating to commercial transactions in which reasonable replacement of derivative financial contracts subject to early termination is carried out, the financial auditor, on the basis of the information received by the FSA from the relevant counterparties and transmitted to it, shall determine the early termination value at the prices of such replacement transactions.

(2) Where the relevant counterparty has not provided documents, certifications or records of the replacement transactions within the time limit set in accordance with Article 4(3), or where the financial auditor concludes that those transactions were not concluded on reasonable commercial terms, the financial auditor shall determine the early termination amount on the basis of:

a) the average price between the best sale offer and the best purchase demand existing in the derivative financial contract market respectively at the end of the day, in accordance with the provisions of Article 10;

b) the difference between the average price referred to in point (a) and the price of the best bid or bid, depending on the direction of the cleared open position in order to estimate the loss or cost considered to be incurred by the relevant counterparty as a result of early termination, taking into account the obtaining or restoration of any hedging transaction related to the derivative financial contract;

c) adjustments to the valuation set out in point (b) in order to reflect the size of the counterparty's exposure and credit risk.

(3) In respect of intra-group liabilities, the financial auditor may determine the amount in accordance with paragraph 2(a), without taking into account paragraphs 2(b) and (c), if the resolution strategy would involve transactions to hedge the position risk of financial derivative contracts terminated early with other intra-group transactions.

(4) For the determination of the early termination value in accordance with paragraph 2, the financial auditor may rely on the following data sources:

a) the assessments generated by the financial auditor's own systems, for standardized products;

b) data available at the level of the insurer subject to resolution, such as internal models and

valuations, including independent price verifications carried out in accordance with the provisions on the valuation of derivatives of Law no. 237/2015;

c) data provided by the relevant counterparty by means other than evidence of transactions communicated in accordance with the provisions of Article 4(3), including data on valuations used in current or previous disputes relating to similar or related transactions;

d) data provided by third parties, such as market data and market maker quotes or securities obtained from CCPs, where a derivative financial contract is cleared by them;

e) any other relevant data.

(5) For the purposes of paragraph 2(b), the FSA, as the resolution authority, may require the insurer subject to resolution to carry out an independent price check by updating the information on the reference date set in accordance with Article 10, using the information available at the end of the day on which the early termination takes place.

SECTION 2: Contracts derived from a compensation set

Article 8

For transactions subject to a netting agreement, the financial auditor, based on the information received by the FSA from the relevant counterparties and transmitted to it, shall establish, for all contracts in a netting set, a single value that the insurer subject to resolution has the legal right to receive or the legal obligation to pay, as a result of the early termination of the financial contracts derived from the netting set.

Article 9

(1) The financial auditor shall determine the amount of obligations arising from contracts arising from a set of netting between a resolution insurer and a CCP, on the basis of the valuation principle set out in Article 6.

(2) The early termination amount shall be determined by the CCP, in accordance with its own procedures applied in cases of non-payment of contractual obligations (default), and shall be communicated to the FSA, as the resolution authority, at the same time as the documents referred to in paragraph 5.

(3) The FSA, as the resolution authority, shall notify that CCP and its competent authority of its decision to terminate the derivative contracts early. The decision to terminate early shall be applied immediately or at a date and time after the date specified in the notice.

(4) The FSA, as the resolution authority, shall request the CCP to disclose the early termination

amount for all derivative financial contracts in the relevant clearing set, in accordance with the steps set out in the procedure applied by that CCP in cases of default of contractual obligations.

(5)The CCP shall make available to the FSA, as the resolution authority, the documents related to the procedure applied by the respective CCP in cases of default of contractual obligations, report the measures to manage the non-payment cases undertaken for the termination of the derivative financial contracts or the full hedging of the position risk of the insurer subject to resolution, who is in default situation.

(6)The FSA, as the resolution authority, on the basis of an agreement concluded with that CCP and its competent authority, shall indicate the deadline by which the CCP must provide the assessment of the early termination amount. To this end, the FSA, the CCP and the CCP's competent authority shall take into account:

- a)the procedure applied by that CCP in cases of default as set out in the CCP's governance rules in accordance with Regulation (EU) No 648/2012;
- b)the calendar of resolution measures, established by the FSA, as resolution authority.

(7)The CCP confirms the FSA, as the resolution authority, that it can communicate the termination amount within the agreed deadline.

(8)By way of exception to the provisions of paragraph (1), the FSA, as the resolution authority, taking into account the circumstances of the specific situation and in exceptional situations, may decide to apply the provisions of Article 7(2), after consulting the competent authority of the CCP, in one of the following situations:

- a)the CCP shall not disclose the assessment of the early termination value within the time limit indicated by the FSA, in its capacity as resolution authority, in accordance with paragraph 6;
- b)The FSA, as the resolution authority, has evidence that the CCP has failed to disclose an assessment of the early termination value in accordance with the procedures pre-established by that CCP.

(9)All information and documents received by A.S.F. based on the provisions of this article are made available to the financial auditor for the fulfillment of his obligations.

SECTION 3: Moments of evaluation

Article 10

The financial auditor must determine the amount of obligations arising from derivative financial contracts at the following times:

- a) on the day and time of the conclusion of the replacement transactions, if the financial auditor determines the early termination value at the prices of the replacement transactions in accordance with the provisions of Article 7(1);
- b) the day and time when the early termination amount was determined by the CCP, where the financial auditor determines the early termination amount in accordance with the procedures predetermined by the CCP in accordance with the provisions of Article 9(2);
- c) on the date of early termination or, if this date is not commercially possible, on the day and time at which a market price is available for the underlying asset of the derivative financial contract, in all other cases.

CHAPTER IV: Final provisions

Article 11

This norm shall be published in the Official Gazette of Romania, Part I, and shall enter into force on the date of publication.

p. The President of the Financial Supervisory Authority,

Gheorghe Cornel Coca Constantinescu

Published in the Official Gazette number 91 of February 8, 2016