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From: Secretary-General of the European Commission,
signed by Mr Jordi AYET PUIGARNAU, Director

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To: Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of
the European Union

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Subject: COMMISSION DELEGATED REGULATION (EU) .../... of 23.5.2016
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

Delegations will find attached document C(2016) 2967 final.

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COMMISSION DELEGATED REGULATION (EU) .../...

of 23.5.2016

**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)

EXPLANATORY MEMORANDUM

1. CONTEXT OF THE DELEGATED ACT

Article 49(5) of Directive (EU) No 2014/59 ('the Directive') empowers the Commission to adopt, following submission of draft standards by the European Banking Authority (EBA), and in accordance with Articles 10 to 14 of Regulation No (EU) 1093/2010, delegated acts specifying methodologies and principles on the valuation of liabilities arising from derivatives.

In accordance with Article 10(1) of Regulation No (EU) 1093/2010 establishing the EBA, the Commission shall decide within three months of receipt of the draft standards whether to endorse the drafts submitted. The Commission may also endorse the draft standards in part only, or with amendments, where the Union's interests so require, having regard to the specific procedure laid down in those Articles.

2. CONSULTATIONS PRIOR TO THE ADOPTION OF THE ACT

In accordance with the third subparagraph of Article 10(1) of Regulation No (EU) 1093/2010, the EBA has carried out a public consultation on the draft technical standards submitted to the Commission in accordance with Article 49(5) of the Directive. A consultation paper was published on the EBA internet site on 13 May 2015, and the consultation closed on 13 August 2015. Moreover, the EBA consulted the ESMA on 13 May 2015 and invited the EBA's Banking Stakeholder Group set up in accordance with Article 37 of Regulation No (EU) 1093/2010 to provide advice on them. Together with the draft technical standards, the EBA has submitted an explanation on how the outcome of these consultations has been taken into account in the development of the final draft technical standards submitted to the Commission.

Together with the draft technical standards, and in accordance with the third subparagraph of Article 10(1) of Regulation No (EU) 1093/2010, the EBA has submitted its Impact Assessment, including its analysis of the costs and benefits, related to the draft technical standards submitted to the Commission. This analysis is available at: <http://www.eba.europa.eu/regulation-and-policy/recovery-and-resolution/rts-defining-methodologies-for-the-valuation-of-derivative-liabilities>, pages 25-34 of the Final Draft Regulatory Technical Standards package.

3. LEGAL ELEMENTS OF THE DELEGATED ACT

The draft Regulatory Technical Standards specify (a) appropriate methodologies for determining the value of classes of derivatives, including transactions that are subject to netting agreements, (b) principles for establishing the relevant point in time at which the value of a derivative position should be established, and (c) appropriate methodologies for comparing the destruction in value that would arise from the close-out and bail-in of derivatives with the amount of losses that would be borne by derivatives in a bail-in.

The standards lay down parameters to be taken into account by resolution authorities prior to their decision to close-out derivative contracts, in order to compare, on the one hand the potential destruction in value which could stem from the close-out, with, on the other, the amount of losses that would be absorbed by bailing-in those derivatives contracts following the close-out. In particular, the potential destruction in value should be based on an analysis of

the costs, expenses and impairments foreseen to be incurred by the institution under resolution as a result of the close-out, due to increased counterparty claims, re-hedging costs, deteriorated franchise value and any precautionary buffer catering for other possible adverse developments.

The methodologies for valuing derivative contracts for bail-in purpose are based on a principle of replacement costs, whereby a derivative counterparty of the institution under resolution is entitled, upon close-out, to a claim covering the losses or costs it incurred, or gains it realised, in replacing or obtaining the economic equivalent on material terms of the contracts and the option rights of the parties in respect of the terminated contract. This 'close-out amount' will be added to unpaid amounts and collateral already due between the counterparties in order to calculate the 'early termination amount' potentially due between the parties.

In order to establish this early termination amount, resolution authorities will communicate their close-out decision to counterparties and determine a deadline for providing evidence of replacement trades. Where a counterparty has provided such evidence by the deadline, the valuer will determine the close-out amount at the price of those replacement trades. However, if the counterparty has not provided such evidence by the deadline or if the valuer concludes that the replacement trades were not concluded on commercially reasonable terms, the valuer will apply a statutory methodology based on mid-market price and bid-offer spreads.

Specific rules are laid down for the valuation of derivatives cleared via EU-authorised or recognised central counterparties (CCP), which will be in principle valued as the early termination amount determined by the CCP in accordance with default management procedures established in application of Regulation (EU) No 648/2012¹ ('EMIR'). Upon communication of the close-out decision the resolution authority will agree with the CCP and the CCP competent authority on the deadline by which the CCP will provide the early termination amount. The valuer will only apply the statutory methodology based on mid-market price and bid-offer spreads under certain conditions where the CCP does not provide the early termination amount within the deadline or where the resolution authority has evidence that the CCP has not provided a valuation of an early termination amount in line with the CCP default procedures.

The point in time for the valuation will be established at the day and time of the conclusion of the replacement trades where the value is determined on the basis of such replacement trades. By contrast, where the value is established by reference to a CCP determination the point in time will be established at the day and time when the early termination amount has been determined by the CCP. Finally, in other cases it will be established at the close-out date or, if that would not be commercially reasonable, the day and time at which a price is available in the market for the underlying asset(s).

¹ 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, (OJ L 201, 27.7.2012, p. 1).

COMMISSION DELEGATED REGULATION (EU) .../...

of 23.5.2016

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)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council², and in particular Article 49(5) thereof,

Whereas:

- (1) Directive 2014/59/EU entrusts resolution authorities with the power to write down and convert liabilities of an institution under resolution.
- (2) Derivative contracts may represent a significant share of the liability structure of certain credit institutions. However, the valuation of such contracts is a complex process given that their value is linked to the value of underlying instruments, assets or entities, which evolves over time and only crystallises at maturity or upon close-out.
- (3) Past experience illustrates that the complexity of valuing derivative liabilities upon failure of one of the counterparties may make the valuation process time-consuming, involve enormous costs and give rise to litigation.
- (4) Furthermore, practice illustrates that derivative contracts may contain different methodologies to determine the amount due between counterparties upon close-out, some of them leaving the determination of the close-out amount or the close-out date, or both, entirely to the non-defaulting counterparty.

² OJ L 173, 12.6.2014, p.190.

- (5) Accordingly, in order to avoid moral hazard and ensure the efficiency of the resolution actions, resolution authorities should adopt and implement appropriate methodologies to value liabilities arising from derivative contracts within a timeframe compatible with the swiftness of the resolution process and based on objective and, where practicable, readily available information. It is important that the valuation methodology sets out some procedural provisions on communication of close-out decisions by the resolution authority as well as on how to obtain replacement trades from the closed-out counterparties.
- (6) Derivative contracts subject to a netting agreement give rise to a single close-out amount in the event of a contractual early termination. Article 49 of Directive 2014/59/EU provides that the value of such contracts is determined on a net basis in accordance with the terms of the agreement. The resolution authority or independent valuer should therefore respect netting sets defined in the netting arrangements without being able to choose certain contracts and exempt others.
- (7) Pursuant to Article 49 of Directive 2014/59/EU, the value of derivative contracts is determined by the resolution authority or independent valuer as part of the valuation process carried out under Article 36 of that Directive. With respect to derivative liabilities, the valuation process should aim to determine a prompt and *ex ante* valuation for bail-in purposes, and at the same time allow the resolution authority adequate flexibility for *ex post* adjustment of claim amounts.
- (8) The assessment of whether to bail-in or to exclude derivative liabilities from the scope of bail-in pursuant to Article 44(3) of Directive 2014/59/EU should be made prior to the decision to close out as part of the valuation process under Article 36 of that Directive.
- (9) The valuation of derivative liabilities should enable resolution authorities to assess, prior to taking a decision to close out, the potential amount by which those liabilities might be bailed in following the close-out, as well as the potential destruction in value which might arise as a result of the close-out.
- (10) The close-out of derivative contracts may crystallise additional losses that are not reflected in the going-concern valuation, stemming for example from actual replacement costs incurred by the counterparty that would increase the close-out costs owed by the institution under resolution, or from costs incurred by the institution under resolution in re-establishing trades on exposures subject to open market risk resulting from the close-out. If the losses incurred or expected to be incurred from the close-out of derivatives exceed the share of the corresponding liabilities that would be effectively available for bail-in, the excess loss may increase the burden of bail-in for other creditors of the institution under resolution. In such cases, the amount of losses that would be borne by liabilities not arising from derivative contracts in a bail-in would be higher than without the close-out and bail-in of derivative contracts, and therefore the resolution authority may consider exempting derivative contracts from bail-in in accordance with Article 44(3)(d) of Directive 2014/59/EU and with the Commission Delegated Regulation (EU) [.../...] ³ adopted under Article 44(11) of that

³ Commission Delegated Regulation (EU) [.../...] of 4 February 2016 specifying further the circumstances where exclusion from the application of write-down or conversion powers is necessary under Article 44(3) of Directive 2014/59/EU of the European Parliament and of the Council

Directive. Any exercise of the bail-in power in relation to such liabilities should be subject to the exemptions set out in Article 44(2) of Directive 2014/59/EU and to the discretionary exemptions laid down in Article 44(3) of that Directive as specified in the Delegated Regulation (EU) [.../...]³.

- (11) Since there is a need for consistent interpretation of paragraphs (3) and (4) of Article 49 of Directive 2014/59/EU, methodologies and principles for the valuation of derivatives carried out by independent valuers and resolution authorities should be specified.
- (12) A valuation methodology relying on actual or hypothetical replacement costs for the closed out liabilities would achieve outcomes similar to predominant market practice and would be consistent with the principles governing the valuation required under Article 74 of Directive 2014/59/EU, which is aimed at establishing whether shareholders and creditors would have received better treatment if the institution under resolution had entered into normal insolvency proceedings (the “no-creditor-worse-off” principle).
- (13) In applying the valuation methodology, the resolution authority should be able to rely on various sources of data, including data sources provided by the institution under resolution, counterparties or third parties. It is nevertheless appropriate to set out principles on the types of data that have to be taken into consideration in the course of the valuation in order to ensure an objective determination of value.
- (14) Counterparties of derivative contracts closed out by resolution authorities may choose to conclude one or more replacement trades to replace their exposure upon close-out. Such replacement trades should constitute a privileged data source for the valuation as long as they are concluded on commercially reasonable terms as at the close-out date or as soon as reasonably practicable thereafter. Resolution authorities should therefore, when communicating the close-out decision, give counterparties the possibility to provide evidence of commercially reasonable replacement trades within a deadline consistent with the expected reference point in time for the valuation. Where counterparties have provided such evidence within the deadline, the valuer should determine the close-out amount at the prices of those replacement trades. If counterparties have not provided evidence of commercially reasonable replacement trades within the deadline, resolution authorities should be able to carry out their valuation on the basis of available market information, such as mid-prices and bid-offer spreads in order to assess hypothetical replacement costs, i.e. the loss or costs that would have been incurred as a result of re-establishing a hedge or a related trading position on a net risk exposure basis.
- (15) Derivative products and markets are very heterogeneous and it is not possible to identify a single market practice for entering into replacement trades. Therefore, the notion of ‘commercially reasonable replacement trades’ has to be broadly defined in order to enable the valuer to conduct the required assessment in all market contexts. That notion should thus be understood as a replacement trade entered into on a netted risk exposure basis, on terms consistent with common market practice and making reasonable efforts in order to obtain best value for money. In particular, the valuer

establishing a framework for the recovery and resolution of credit institutions and investment firms (OJ [...]).

could consider, among other elements, the number of dealers approached by the counterparty, the number of firm quotes obtained, and whether the quote offering the best price has been chosen. The resolution authority should also be able to specify in the close-out notice the criteria that it will apply in its assessment.

- (16) Union legislation adopted in recent years has, in line with international standards, sought to increase transparency and risk mitigation in the market for derivative contracts by providing for mandatory clearing through central counterparties ('CCP') for standardised over-the-counter ('OTC') derivatives, valuation and margining requirements for CCP-cleared derivatives and for a wide range of OTC derivatives and mandatory reporting to trade depositories for all OTC derivatives.
- (17) In the event that a CCP clearing member is placed under resolution, and the resolution authority closed-out derivative contracts prior to a bail-in, that clearing member would qualify as a defaulting clearing member with regard to the CCP in relation to the particular netting set(s). The internal procedures and mechanisms governing the default of a clearing member ('CCP default procedures') implemented by CCPs in light of the requirements of Regulation (EU) No 648/2012, offer a reliable basis to determine the value of the derivative liability arising across the netting set from the close-out, also in the context of bail-in in a resolution process.
- (18) Conducting CCP default procedures may take several days or more following the trigger event. For the particular case of resolution, waiting for the completion of default procedures over a very long period in order to set the value of derivatives could undermine the resolution timeline and objectives and could result in unnecessary disruption in financial markets. It is therefore necessary for the resolution authority to agree with the CCP and the CCP's competent authority on a deadline by which the early termination amount has to be determined, taking into account both the constraints of the CCP and those of the resolution authority.
- (19) The early termination amount determined by the CCP in line with its default management procedures within the agreed deadline should be endorsed by the valuer. Where the CCP fails to determine the early termination amount within the agreed deadline or does not apply its default procedures, the resolution authority should have the possibility to rely on its own estimates to determine the early termination amount. The resolution authority should also be able to apply a provisional determination based on its own estimates where such action is justified by the urgency of the resolution process and provided it updates its valuation upon completion of the CCP default procedure at the expiry of the deadline. The resolution authority should be able to consider information provided by the CCP after the deadline in the *ex post* definitive valuation, if available at that time, and in any event when performing the valuation of difference in treatment pursuant to Article 74 of Directive 2014/59/EU. This Regulation should be without prejudice to the default management procedures run by CCPs in accordance with Regulation (EU) No 648/2012.
- (20) The provisions in this Regulation should not affect CCP internal procedures for the transfer of the assets and positions established between a defaulting clearing member and its clients, adopted in accordance with Article 48(4) of Regulation (EU) No 648/2012, and should be consistent with any other relevant provisions or conditions of authorisation which might affect the close-out of the relevant derivative contracts.

- (21) The point in time for the valuation of derivative contracts should reflect the valuation principle which takes into account the actual or the hypothetical replacement costs incurred by counterparties. In order for the valuation to be as accurate as possible, the valuation should be carried out on the close-out date or, if that would not be commercially reasonable, the first day and time on which a market price is available for the underlying asset. In those cases where the early termination amount is determined by a CCP or is determined at the price of replacement trades, the reference point in time should be that of the CCP determination or that of the replacement trades.
- (22) If the resolution authority, due to urgency, decides to carry out a provisional valuation pursuant to Article 36(9) of Directive 2014/59/EU, the resolution authority or the valuer should be able, as part of that provisional valuation, to produce a provisional determination of the value of derivative liabilities prior to that reference point in time, based on value estimates and available data as at that time. Where the resolution authority takes resolution action on the basis of the provisional valuation in accordance with Article 36(12) of Directive 2014/59/EU, relevant market developments observed or evidence of actual replacement trades at the reference point in time would either be reflected in a subsequent provisional valuation or, in the final valuation carried out pursuant to Article 36(10) of that Directive.
- (23) This Regulation is based on the draft regulatory technical standards submitted by the European Banking Authority to the Commission.
- (24) The European Banking Authority has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, has consulted the European Securities and Markets Authority, has analysed the potential related costs and benefits and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010 of the European Parliament and of the Council⁴.

HAS ADOPTED THIS REGULATION:

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 Delegated

⁴ Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12).

Regulation (EU) [...] ⁵ 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:
 - (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

⁵ Commission Delegated Regulation (EU) [...] 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 [...]).

- (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 also provide to the resolution authority a summary of any commercially reasonable replacement trades.
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.

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 Council⁶;
 - (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).

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.

⁶ 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).

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:
 - (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, 23.5.2016

For the Commission
The President
Jean-Claude JUNCKER