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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
No. Cion doc.:	C(2016) 6329 final
Subject:	COMMISSION DELEGATED REGULATION (EU) No …/.. of 4.10.2016 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories with regard to regulatory technical standards for risk-mitigation techniques for OTC derivative contracts not cleared by a central counterparty

Delegations will find attached document C(2016) 6329 final.

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EUROPEAN
COMMISSION

Brussels, 4.10.2016
C(2016) 6329 final

COMMISSION DELEGATED REGULATION (EU) No …/..

of 4.10.2016

supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories with regard to regulatory technical standards for risk-mitigation techniques for OTC derivative contracts not cleared by a central counterparty

(Text with EEA relevance)

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EXPLANATORY MEMORANDUM

1. CONTEXT OF THE DELEGATED ACT

Article 11(15) of Regulation (EU) No 648/2012 ('the Regulation') as amended by Regulation (EU) No 575/2013 ('CRR') empowers the Commission to adopt, following submission of draft standards by the European Banking Authority, the European Insurance and Occupational Pensions Authority and the European Securities and Market Authority, which constitute the European Supervisory Authorities (ESA), and in accordance with either Articles 10 to 14 of Regulation (EU) No 1093/2010, Regulation (EU) No 1094/2010 and Regulation (EU) No 1095/2010 delegated acts specifying the risk-management procedures, including the levels and type of collateral and segregation arrangements required for compliance with paragraph 3 of Article 11 of the Regulation, the procedures for the counterparties and the relevant competent authorities to be followed when applying exemptions under paragraphs 6 to 10 and the applicable criteria referred to in paragraphs 5 to 10 including in particular what should be considered as practical or legal impediment to the prompt transfer of own funds and repayment of liabilities between the counterparties.

In accordance with Article 10(1) of Regulation (EU) No 1093/2010, Regulation (EU) No 1094/2010 and Regulation (EU) No 1095/2010 establishing the ESA, 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.

On 8 March 2016, the ESA submitted to the Commission the draft regulatory technical standards. On 28 July 2016, the Commission notified the ESA of its intention to endorse the draft regulatory technical standards subject to a number of changes in accordance Article 10(1) of Regulation (EU) No 1093/2010, Regulation (EU) No 1095/2010 and Regulation (EU) No 1094/2010. On 8 September 2016, the ESA submitted to the Commission a formal opinion on the Commission letter and the revised regulatory technical standards. While the ESA retained most of the amendments proposed by the Commission, the ESA proposed to reject several amendments, in particular the one related to the removal of concentration limits on initial margins for pension scheme arrangements on the basis that this is an important element for protecting counterparties to OTC derivatives transactions against losses resulting from the default of their counterparty. While the Commission supports the ESA intention, taking into consideration the costs and risks of foreign currency mistmatches and additional counterparty risks that the application of such concentration limits would entail, the Commission deems it more appropriate to replace the concentration limits by specific management risk tools to monitor and address potential risks which application should be reviewed after three years of their implementation.

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2. CONSULTATIONS PRIOR TO THE ADOPTION OF THE ACT

In accordance with the third subparagraph of Article 10(1) of Regulation (EU) No 1093/2010, Regulation (EU) No 1094/2010 and Regulation (EU) No 1095/2010, the ESA have carried out a public consultation on the draft technical standards submitted to the Commission in accordance with Article 11(15) of Regulation (EU) No 648/2012. A discussion paper and two consultation papers were published on the ESA websites respectively on 6 March 2012, 14 April 2014 and 10 June 2015. Together with these draft technical standards, the ESA have 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 (EU) No 1093/2010, Regulation (EU) No 1094/2010 or Regulation (EU) No 1095/2010, the ESA have submitted its impact assessment, including its analysis of the costs and benefits, related to the draft technical standard submitted to the Commission. This analysis is available at https://eiopa.europa.eu/Pages/Publications/Draft-Regulatory-Technical-Standards-on-margin-requirements-for-non-centrally.aspx.

3. LEGAL ELEMENTS OF THE DELEGATED ACT

This delegated act covers three mandates in the following areas:

(a) the risk-management procedures, including the levels and type of collateral and segregation arrangements;

(b) the procedures for the counterparties and the relevant competent authorities to be followed when applying exemptions for intragroup OTC derivative contracts;

(c) the applicable criteria on what should be considered as practical or legal impediment to the prompt transfer of own funds and repayment of liabilities arising from OTC derivative contracts between the counterparties belonging to the same group.

This delegated act is structured in four chapters. Since the first chapter is more complex, it was necessary to split it further in various sections.

The first chapter covers all the requirements concerning the risk management procedures for the margin exchange, detailed procedures for specific cases, the approaches to be applied for the margin calculation, the procedures around the margin collection, the eligibility, valuation and treatment of collateral, the operational aspects and requirements concerning the trading documentation. The second chapter includes exemptions from these requirements.

The third chapter includes the procedures for the counterparties and the relevant competent authorities when applying exemptions for intragroup derivative contracts including process, timing and notifications to authorities.

The criteria for applying exemptions for intragroup derivative contracts and what has to be considered a practical or legal impediment are specified in the third chapter. In particular,

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legal impediments include not only regulatory constraints but also constraints that may arise by internal restrictions or legally binding agreements within and outside the group.

A fourth chapter includes transitional and final provisions. The need for international convergence, the possibility of regulatory arbitrage, and the specific characteristics of the OTC derivative market within the Union make necessary a staggered implementation of these requirements in some specific cases such as intragroup transactions, equity options and foreign exchange forwards.

In developing this delegated act, the ESA took into account the Basel Committee-IOSCO margin framework for non-centrally cleared OTC derivatives and the Basel Committee guidelines for managing settlement risk in foreign exchange transactions.

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COMMISSION DELEGATED REGULATION (EU) No …/..

of 4.10.2016

supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories with regard to regulatory technical standards for risk-mitigation techniques for OTC derivative contracts not cleared by a central counterparty

(Text with EEA relevance)

THE EUROPEAN COMMISSION,

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

Having regard to Regulation (EU) 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories[1], and in particular Article 11(15) thereof,

Whereas:

(1) Counterparties have an obligation to protect themselves against credit exposures to derivatives counterparties by collecting margins where those contracts are not cleared by a central counterparty. This Regulation lays out the standards for the timely, accurate and appropriately segregated exchange of collateral. These standards should apply on a mandatory basis to the collateral that counterparties are required to collect or post pursuant to this Regulation. However, counterparties which agree to collecting or posting collateral beyond the requirements of this Regulation should be able to choose whether or not to exchange such collateral in accordance with these standards.

(2) Counterparties subject to the requirements of Article 11(3) of Regulation (EU) No 648/2012 should take into account the different risk profiles of non-financial counterparties that are below the clearing threshold referred to in Article 10 of that Regulation when establishing their risk management procedures for over-the-counter ("OTC") derivative contracts concluded with such entities. It is therefore appropriate to allow counterparties to determine whether or not the level of counterparty credit risk posed by those non-financial counterparties that is below that clearing threshold needs to be mitigated through the exchange of collateral. Given that non-financial counterparties established in a third country that would be below the clearing threshold if established in the Union can be assumed to have the same risk profiles as non-financial counterparties below the clearing threshold established in the Union, the same approach should be applied to both types of entities in order to prevent regulatory arbitrage.

[1] OJ L 201, 27.7.2012, p.1.

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(3) Counterparties to non-centrally cleared OTC derivatives contracts need to be protected from the risk of a potential default of the other counterparty. Therefore, two types of collateral in the form of margins are necessary to properly manage the risks to which those counterparties are exposed. The first type is variation margin, which protects counterparties against exposures related to the current market value of their OTC derivative contracts. The second type is initial margin, which protects counterparties against potential losses which could stem from movements in the market value of the derivatives position occurring between the last exchange of variation margin before the default of a counterparty and the time that the OTC derivative contracts are replaced or the corresponding risk is hedged.

(4) Since central counterparties ("CCPs") might be authorised as a credit institution according to Union legislation, it is necessary to exclude non-centrally cleared OTC derivative contracts that CCPs enter into during a default management process from the requirements of this Regulation since those contracts are already subject to the provisions of Commission Delegated Regulation (EU) No 153/2013[2] and therefore they are not subject to the provisions of this Regulation.

(5) For non-centrally cleared OTC derivative contracts that involve the payment of a premium upfront to guarantee the performance of the contract, the counterparty receiving the payment of the premium (‘option seller’) does not have a current or potential future exposure to the counterparty. Also, the daily mark-to-market value of such contracts is already covered by the payment of this premium. Therefore, where the netting set consists of such option positions, the option seller should be able to choose not to collect initial or variation margins for these types of OTC derivatives as long as the option seller is not exposed to any credit risk. The counterparty paying the premium ("option buyer") should however collect both initial and variation margins.

(6) While dispute resolution processes contained in bilateral agreements between counterparties are useful for minimising the length and frequency of disputes, counterparties should, in the first instance, collect at least the undisputed amount in case the amount of a margin call is disputed. This will mitigate the risk arising from the disputed transactions and therefore ensure that non-centrally cleared OTC derivative contracts are collateralised to the extent possible.

(7) In order to guarantee a level playing field across jurisdictions, where a counterparty established in the Union enters into a non-centrally cleared OTC derivative contract with a counterparty that is established in a third country, initial and variation margins should be exchanged in both directions. Counterparties established in the Union transacting with counterparties established in third countries should remain subject to the obligation of assessing the legal enforceability of the bilateral agreements and the effectiveness of the segregation agreements.

(8) It is appropriate to allow counterparties to apply a minimum transfer amount when exchanging collateral in order to reduce the operational burden of exchanging limited sums when exposures move only slightly. However, it should be ensured that such minimum transfer amount is used as an operational tool and not with the view to

[2] Commission Delegated Regulation (EU) No 153/2013 of 19 December 2012 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on requirements for central counterparties

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serving as an uncollateralised credit line between counterparties. Therefore, a maximum level should be set out for that minimum transfer amount.

(9) For operational reasons, it might be more appropriate in some cases to have separate minimum transfer amounts for the initial and the variation margin. In those cases it should be possible for counterparties to agree on separate minimum transfer amounts for variation and initial margin. However, the sum of the separate minimum transfer amounts should not exceed the maximum level of the minimum transfer amount. For practical reasons, it should be possible to define the minimum transfer amount in the currency in which margins are normally exchanged, which may not be the euro.

(10) Some third country jurisdictions may determine a different scope to Regulation (EU) No 648/2012 for the purposes of their requirements for the exchange of collateral in relation to OTC derivative contracts that are not centrally cleared. Therefore, were this Regulation to require that only non-centrally cleared OTC derivative contracts governed by Regulation (EU) No 648/2012 are included in the margin calculations for cross-border netting sets, counterparties in different jurisdictions would potentially have to duplicate required calculations to take into account different definitions or different scopes of products under the respective margin requirements. This could lead to distorted margin calculations. Furthermore, this would likely increase the risk of disputes. Therefore, allowing the use of a broader set of products in cross-border netting sets that includes all the OTC derivative contracts that are subject to exchange of collateral in one or the other jurisdiction would facilitate a smoother process of margin collection. This approach is consistent with the systemic risk-reduction goal of Regulation (EU) No 648/2012, since a broader range of products would be subject to the margin requirements.

(11) Counterparties may choose to collect initial margins in cash, in which case the collateral should not be subject to any haircut, provided that the currency of the collateral matches the currency in which the contract is expressed. However, where initial margins are collected in cash in a currency different than the currency in which the contract is expressed, currency mismatch may generate foreign exchange risk. For this reason, a currency mismatch haircut should apply to initial margins collected in cash in another currency. For variation margins collected in cash no haircut is necessary in line with the BCBS-IOSCO framework, even where the payment is executed in a different currency than the currency of the contract.

(12) When setting the level of initial margin requirements, the Basel Committee on Banking Supervision and the Board of the International Organization of Securities Commissions have explicitly considered two aspects, as reflected in their framework, "Margin requirements for non-centrally cleared derivatives" of March 2015 (‘BCBS-IOSCO framework’). The first aspect is the availability of high credit quality and liquid assets covering the initial margin requirements. The second is the proportionality principle, as smaller financial and non-financial counterparties might be hit in a disproportionate manner from the initial margin requirements. In order to maintain a level playing field, this Regulation should introduce a threshold that is exactly the same as in the BCBS-IOSCO framework below which two counterparties are not required to exchange initial margin. This should substantially alleviate costs and operational burden for smaller participants and address the concern about the availability of high credit quality and liquid assets without undermining the general objectives of Regulation (EU) No 648/2012.

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(13) While the thresholds should always be calculated at group level, investment funds should be treated as a special case as they can be managed by a single investment manager and captured as a single group. However, where the funds are distinct pools of assets and they are not collateralised, guaranteed or supported by other investment funds or the investment manager itself, they are relatively risk remote in relation to the rest of the group. Such investment funds should therefore be treated as separate entities when calculating the thresholds, in line with the BCBS-IOSCO framework.

(14) With regard to initial margin, the requirements of this Regulation are likely to have a measurable impact on market liquidity, as assets provided as collateral cannot be liquidated or otherwise reused for the duration of the non-centrally cleared OTC derivative contract. Such requirements represent a significant change in market practice and present certain operational and practical challenges that will need to be managed as the new requirements come into effect. Taking into account that the variation margin already covers realised fluctuations in the value of non-centrally cleared OTC derivatives contracts up to the point of default, it is considered proportionate to apply a threshold of EUR 8 billion in gross notional amounts of outstanding contracts to the application of the initial margin requirements. This threshold applies at the group level or, where the counterparty is not part of a group, at the level of the single entity. The aggregated gross notional amount of outstanding contracts should be used as an adequate reference given that it is an appropriate metric for measuring the size and complexity of a portfolio of non-centrally cleared OTC derivative contracts. It is also a reference that is easy to monitor and report. These thresholds are also in line with the BCBS-IOSCO framework for non-centrally cleared OTC derivative contracts and are therefore consistent with international standards.

(15) Exposures arising either from contracts or counterparties that are permanently or temporarily exempted or partially exempted from margins, should also be included in the calculation of the aggregated gross notional amount. This is due to the fact that all the contracts contribute to the determination of the size and complexity of a counterparty's portfolio. Therefore, non-centrally cleared OTC derivative contracts that may be exempted from the requirements of this Regulation are also relevant for determining the size, scale and complexity of the counterparty's portfolio and should therefore also be included in the calculation of the thresholds.

(16) It is appropriate to set out special risk management procedures for certain types of non-centrally cleared OTC derivative contracts that show particular risk profiles. In particular, the exchange of variation margin without initial margin should, consistent with the BCBS-IOSCO framework, be considered an appropriate exchange of collateral for physically-settled foreign exchange contracts. Similarly, as cross-currency swaps can be decomposed into a sequence of foreign exchange forwards, only the interest rate component should be covered by initial margin.

(17) Account should be taken of the impediments faced by covered bonds issuers or cover pools in providing collateral. Under a specific set of conditions, covered bonds issuers or cover pools should therefore not be required to post collateral. This should allow for some flexibility for covered bonds issuers or cover pools while ensuring that the risks for their counterparties are limited. Covered bond issuers or cover pools may face legal impediments to posting and collecting non-cash collateral for initial or variation margin or posting variation margin in cash since variation margin payment could be considered a claim that ranks senior to the bond holder claims, which could result in a

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legal impediment. Similarly, the possibility to substitute or withdraw initial margin could be considered a claim that ranks senior to the bond holder claims facing the same type of constraints. However, there are no constraints on a covered bond issuer or cover pool to return cash previously collected as variation margin. Counterparties of covered bond issuers or cover pools should therefore be required to post variation margin in cash and should have the right to get back part or all of it, but the covered bond issuers or cover pools should only be required to post variation margin for the amount in cash that was previously received.

(18) Counterparties should always assess the legal enforceability of their netting and segregation agreements. Where, with respect to the legal framework of a third country, these assessments turn out to be negative, counterparties should rely on arrangements different from the two-way exchange of margins. With a view to ensuring consistency with international standards, to avoid that it becomes impossible for Union counterparties to trade with counterparties in those jurisdictions, and to ensure a level playing field for Union counterparties, it is appropriate to set out a minimum threshold below which counterparties can trade with counterparties established in those jurisdictions without exchanging initial or variation margins. Where the counterparties have the possibility to collect margins and can ensure that for collected collateral, as opposed to posted collateral, the provisions of this Regulation can be met, Union counterparties should always be required to collect collateral. Exposures from contracts with counterparties established in third country jurisdictions that are not covered by any exchange of collateral because of the legal impediments in those jurisdictions should be constrained by setting a limit, as capital is not considered equivalent to margin exchange in relation to the exposures arising from non-centrally cleared OTC derivative contracts and not all counterparties subject to the margin requirements under this Regulation are also subject to capital requirements. This limit should be set in such a way that it is simple to calculate and verify. To avoid the build-up of systemic risk and to avoid that such specific treatment creates the possibility to circumvent the provisions of this Regulation, the limit should be set at a conservative level. These treatments would be considered sufficiently prudent, because there are also other risk mitigation techniques as an alternative to margins.

(19) In order to safeguard against the case where collateral cannot be liquidated immediately after the default of a counterparty, it is necessary, when calculating initial margin to take into account the time period from the most recent exchange of collateral covering a netting set of contracts with a defaulting counterparty until the contracts are closed out and the resulting market risk is re-hedged. This time period is known as the 'margin period of risk' (‘MPOR’) and is the same tool as that used in Article 272(9) of Regulation (EU) No 575/2013 of the European Parliament and of the Council[3], with respect to counterparty credit risk of credit institutions. Nevertheless, as the objectives of the two Regulations differ, and Regulation (EU) No 575/2013 sets out rules for calculating the MPOR for the purpose of own funds requirements only, this Regulation should include specific rules on the MPOR that are required in the context of the risk management procedures for non-centrally cleared OTC derivative

[3] 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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contracts. The MPOR should take into account the processes required by this Regulation for the exchange of margins.

(20) Initial and variation margin should generally be exchanged no later than the end of the business day following the day of execution. However, an extension of the time for the exchange of variation margin is permitted where compensated by an adequate calculation of the MPOR. Alternatively, where no initial margin requirements apply, an extension should be allowed if an appropriate amount of additional variation margin is collected.

(21) When developing initial margin models and when calculating the appropriate MPOR, counterparties should take into account the need to have models that capture the liquidity of the market, the number of participants in that market and the volume of the relevant OTC derivative contracts. At the same time there is the need to develop a model that both parties can understand, reproduce and on which they can rely to resolve disputes. Therefore counterparties should be allowed to calibrate the model and calculate MPOR dependent only on market conditions, without the need to adjust their estimates to the characteristics of specific counterparties. This in turn implies that counterparties may choose to adopt different models to calculate the amounts of initial margin to be exchanged between them, and that those amounts of initial margin may not be symmetrical.

(22) While there is a need for recalibrating an initial margin model with sufficient frequency, a new calibration might lead to unexpected levels of margin requirements. For this reason, an appropriate time period should be established, during which margins may still be exchanged based on the previous calibration. This should give counterparties enough time to comply with margin calls resulting from the recalibration.

(23) Collateral should be considered as being freely transferable if, in the case of a default of the poster of collateral, there are no regulatory or legal impediments or third party claims, including those of the third party custodian. However, certain claims, such as costs and expenses incurred for the transfer of the collateral, in the form of liens routinely imposed on all securities transfers, should not be considered an impediment as that would lead to a situation where an impediment would always be identified.

(24) The collecting counterparty should have the operational capability to liquidate the collateral in the case of a default of the poster of collateral. The collecting counterparty should also be able to use the cash proceeds of liquidation to enter into an equivalent contract with another counterparty or to hedge the resulting risk. Having access to the market should therefore be a pre-requisite for the collector of collateral to enable it to either sell the collateral or repo it within a reasonable amount of time. This capability should be independent of the poster of collateral.

(25) Collateral collected must be of sufficiently high liquidity and credit quality to allow the collecting counterparty to liquidate the positions without suffering a loss due to significant changes in value in case the other counterparty defaults. The credit quality of the collateral should be assessed relying on recognised methodologies such as the ratings of external credit assessment institutions. In order to mitigate the risk of mechanistic reliance on external ratings, however, a number of additional safeguards should be introduced. Those safeguards should include the possibility to use an

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approved Internal Rating Based ('IRB') model and the possibility to delay the replacement of collateral that becomes ineligible due to a rating downgrade, with the view to efficiently mitigating potential cliff effects that may arise from excessive reliance on external credit assessments.

(26) While haircuts mitigate the risk that collected collateral is not sufficient to cover margin needs in a time of financial stress, other risk mitigants are also needed when accepting non-cash collateral in order to ensure that it can be effectively liquidated In particular, counterparties should ensure that the collateral collected is reasonably diversified in terms of individual issuers, issuer types and asset classes.

(27) The impact on financial stability of liquidating the collateral posted by non-systemically important counterparties is limited. Further, concentration limits on initial margin might be burdensome for counterparties with small OTC derivative portfolios as they might have only a limited range of eligible collateral available to post. Therefore, even though collateral diversification is a valid risk mitigant, non-systemically important counterparties should not be required to diversify collateral. On the other hand, systemically important financial institutions and other counterparties with large OTC derivative portfolios trading with each other should apply the concentration limits at least to initial margin including with respect to eligible collateral comprising Member States’ sovereign debt securities. Those counterparties are sophisticated enough to either transform collateral or to access multiple markets and issuers to sufficiently diversify the collateral posted. Article 131 of Directive 2013/36/EU of the European Parliament and of the Council[4] provides for the identification of institutions as systemically important under Union law. However, given the broad scope of Regulation (EU) No 648/2012, a quantitative threshold should be introduced so that the requirements for concentration limits apply also to counterparties that might not fall under those existing classifications of systemically important institutions but which should nonetheless be subject to concentration limits because of the size of their OTC derivative portfolios.

(28) Pension scheme arrangements are subject to bilateral collateralisation requirements. It is, however, important to avoid excessive burden from those requirements on the expected performance of those schemes and, consequently, on the retirement income of future pensioners. Pension scheme arrangements’ liabilities to retirees are denominated in local currencies and their investments must therefore be denominated in the same currency in order to avoid the costs and risks of foreign currency mismatches. It is therefore appropriate to provide that concentration limits do not apply to pension scheme arrangements in the same manner as for other counterparties. However, it is important that adequate risk management procedures are in place to monitor and address potential concentration risks arising from that special regime. The application of these provisions with regard to pension scheme arrangements should be monitored and reviewed in light of market developments.

(29) Difficulties in segregating cash collateral should be acknowledged by allowing counterparties to post a limited amount of initial margin in the form of cash and by

[4] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338).

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allowing custodians to reinvest this cash collateral. However, cash held by a custodian is a liability that the custodian has towards the posting counterparty, which generates a credit risk for the posting counterparty. Therefore, in order to reduce systemic risk, the use of cash as initial margin should be subject to diversification requirements at least for systemically important institutions. Systemically important institutions should be required to either limit the amount of initial margin collected in cash or to diversify the exposures by using more than one custodian.

(30) The value of collateral should not exhibit a significant positive correlation with the creditworthiness of the poster of collateral or the value of the underlying non-centrally cleared derivatives portfolio since this would undermine the effectiveness of the protection offered by the collateral collected. Accordingly, securities issued by the poster of collateral or its related entities should not be accepted as collateral. Counterparties should also be required to monitor that collateral collected is not subject to other forms of wrong way risk.

(31) It should be possible for the non-defaulting counterparty to liquidate assets collected as collateral as initial or variation margin in a sufficiently short time in order to protect against losses on non-centrally cleared OTC derivative contracts in the event of a counterparty default. These assets should therefore be highly liquid and should not be exposed to excessive credit, market or foreign exchange risk. To the extent that the value of the collateral is exposed to these risks, appropriately risk-sensitive haircuts should be applied.

(32) In order to ensure the timely transfer of collateral, counterparties should have efficient operational processes in place. This requires that the processes for the bilateral exchange of collateral are sufficiently detailed, transparent and robust. A failure by counterparties to agree upon and establish an operational framework for efficient calculation, notification and finalisation of margin calls can lead to disputes and failed exchanges of collateral that result in uncollateralised exposures under OTC derivative contracts. As a result, it is essential that counterparties set clear internal policies and standards in respect of collateral transfers. Any deviation from those policies should be rigorously reviewed by all relevant internal stakeholders that are required to authorise those deviations. Furthermore, all applicable terms in respect of operational exchange of collateral should be accurately recorded in detail in a robust, prompt and systematic way.

(33) An exchange of collateral agreement should be concluded between counterparties entering into non-centrally cleared OTC derivative contracts in order to provide legal certainty. As a result, the exchange of collateral agreement should include all material rights and obligations of the counterparties applicable to non-centrally cleared OTC derivative contracts.

(34) Collateral protects the collecting counterparty in the event of the default of the posting counterparty. However, both counterparties are also responsible for ensuring that the manner in which collateral collected is held does not increase the risk of a loss of excess posted collateral for the posting counterparty in case the collecting counterparty defaults. For this reason, the bilateral agreement between the counterparties should allow both counterparties to access the collateral in a timely manner when they have the right to do so, hence the need for rules on segregation and for rules providing for

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an assessment of the effectiveness of the agreement in this respect, taking into account the legal constraints and the market practices of each jurisdiction.

(35) The re-hypothecation, re-pledge or re-use of collateral collected as initial margins would create new risks for counterparties due to claims of third parties over the assets in the event of a default. Legal and operational complications could delay the return of the collateral in the event of a default of the initial collateral collector or the third party or even make it impossible. In order to preserve the efficiency of the framework and ensure a proper mitigation of counterparty credit risks, the re-hypothecation, re-pledge or re-use of collateral collected as initial margin should therefore not be permitted.

(36) Given the difficulties in segregating cash, the current practices for the exchange of cash collateral in certain jurisdictions and the need for reliance on cash instead of securities in certain circumstances where transferring securities may be impeded by operational constraints, cash collateral collected as initial margin should always be held by a central bank or third party credit institution, since this ensures the separation from the two counterparties to the contract. To ensure such separation, the third party credit institution should not belong to the same group as either of the counterparties.

(37) When a counterparty notifies the relevant competent authority regarding its intention to take advantage of the exemption of intragroup transactions, in order for the competent authority to decide whether the conditions for the exemption are met, the counterparty should provide a complete file including all relevant information necessary for the competent authority to complete its assessment.

(38) For a group to be deemed to have adequately sound and robust risk management procedures, a number of conditions have to be met. The group should ensure a regular monitoring of the intragroup exposures, and the timely settlement of the obligations resulting from the intragroup OTC derivative contracts should be guaranteed based on the monitoring and liquidity tools at group level that are consistent with the complexity of the intragroup transactions.

(39) In order for the exemption for intragroup transactions to be applicable, it must be certain that no legislative, regulatory, administrative or other mandatory provisions of applicable law could legally prevent the intragroup counterparties from meeting their obligations to transfer monies or repay liabilities or securities under the terms of the intragroup transactions. Similarly, there should be no operational or business practices of the intragroup counterparties or the group that could result in funds not being available to meet payment obligations as they fall due on a day-to-day basis, or in prompt electronic transfer of funds not being possible.

(40) This Regulation includes a number of detailed requirements to be met for a group to obtain the exemption from posting margin for intragroup transactions. In addition to those requirements, where one of the two counterparties in the group is domiciled in a third-country for which an equivalence determination under Article 13(2) of Regulation (EU) No 648/2012 has not yet been provided, the group has to exchange, variation and appropriately segregated initial margins for all the intragroup transactions with the subsidiaries in those third-countries. In order to avoid a disproportionate application of the margin requirements and taking into account similar requirements for clearing obligations, this Regulation should provide for a delayed implementation of that particular requirement. This would allow enough time

for completion of the process to produce the equivalence determination, while not requiring an inefficient allocation of resources to the groups with subsidiaries domiciled in third-countries.

(41) Taking into account the principle of proportionality, counterparties that have smaller portfolios and therefore generally smaller operations should be allowed more time to adapt their internal systems and processes in order to comply with the requirements of this Regulation. In order to achieve a proper balance between mitigating the risks arising from non-centrally cleared OTC derivatives and the proportionate application of this Regulation, as well as to achieve international consistency and minimise possibilities of regulatory arbitrage with the view to avoiding market disruption, a phase-in period of the requirements is necessary. The phase-in period for the requirements introduced in this Regulation takes into account the schedule agreed in the BCBS-IOSCO framework, which was established by reference to a quantitative impact study involving Union credit institutions.

(42) Commission Delegated Regulation No [PO: please insert reference of Commission Delegated Regulation referred to in Article 4(2) of Directive 2014/65/EU][5] specifies the definition of physically-settled foreign exchange forwards within the Union. However, at this juncture, that definition is not applicable and those products are defined in a non-homogenous way in the Union. Therefore, in order to avoid creating an un-level playing field within the Union, it is necessary that the application of the corresponding risk mitigation techniques are aligned to the date of application of the relevant Delegated Act. A specific date on which the relevant requirements should in any case apply is also set out to avoid excess delays in the introduction of the risk mitigation techniques.

(43) In order to avoid market fragmentation and ensure a level playing field for Union counterparties established in the Union on a global level, and acknowledging the fact that in some jurisdictions the exchange of variation and initial margin for single-stock options and equity index options is not subject to equivalent margin requirements, the treatment of those products should be phased-in. This phase-in period will provide time for monitoring regulatory developments in other jurisdictions and ensuring that appropriate requirements are in place in the Union to mitigate counterparty credit risk in respect of such contracts whilst avoiding scope for regulatory arbitrage.

(44) For reasons of legal certainty and to avoid potential disruptions in financial markets, it is appropriate to clarify the treatment of existing contracts.

(45) This Regulation is based on the draft regulatory technical standards submitted to the Commission by the European Banking Authority, the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority.

(46) The European Banking Authority, the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority have conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37

[5] [PO: Full reference]

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of Regulation (EU) No 1093/2010 of the European Parliament and of the Council[6], the opinion of the Insurance and Reinsurance Stakeholder Group and the Occupational Pensions Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1094/2010 of the European Parliament and of the Council[7], and the Securities and Markets Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1095/2010 of the European Parliament and of the Council[8].

(47) In accordance with the procedure set out in the fifth, sixth and seventh sub-paragraphs of Article 10(1) of Regulation (EU) No 1093/2010, in the fifth, sixth and seventh sub-paragraphs of Article 10(1) of Regulation (EU) No 1095/2010 and in the fifth, sixth and seventh sub-paragraphs of Article 10(1) of Regulation (EU) No 1094/2010, this Regulation incorporates amendments to the draft regulatory technical standards, resubmitted in the form of a formal opinion to the Commission by the European Banking Authority, the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority, on the basis of the Commission's proposed amendments,

HAS ADOPTED THIS REGULATION:

Chapter I

General Provisions on Risk Management Procedures

SECTION 1

DEFINITIONS AND GENERAL REQUIREMENTS

Article 1
Definitions

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

(1) 'initial margin' means the collateral collected by a counterparty to cover its current and potential future exposure in the interval between the last collection

6 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).

7 Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/79/EC (OJ L 331, 15.12.2010, p. 48).

8 Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC (OJ L 331, 15.12.2010, p. 84).

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of margin and the liquidation of positions or hedging of market risk following a default of the other counterparty;

(2) 'variation margin' means the collateral collected by a counterparty to reflect the results of the daily marking-to-market or marking-to-model of outstanding contracts referred to in Article 11(2) of Regulation (EU) No 648/2012;

(3) 'netting set' means a set of non-centrally cleared over-the counter ("OTC") derivative contracts between two counterparties that is subject to a legally enforceable bilateral netting agreement.

Article 2
General requirements

1. Counterparties shall establish, apply and document risk management procedures for the exchange of collateral for non-centrally cleared OTC derivative contracts.

2. The risk management procedures referred to in paragraph 1 shall include procedures providing for or specifying the following:

(a) the eligibility of collateral for non-centrally cleared OTC derivative contracts in accordance with Section 2;

(b) the calculation and collection of margins for non-centrally cleared OTC derivative contracts in accordance with Section 3;

(c) the management and segregation of collateral for non-centrally cleared OTC derivative contracts in accordance with Section 5;

(d) the calculation of the adjusted value of collateral in accordance with Section 6;

(e) the exchange of information between counterparties and the authorisation and recording of any exceptions to the risk management procedures referred to in paragraph 1;

(f) the reporting of the exceptions set out in Chapter II to senior management;

(g) the terms of all necessary agreements to be entered into by counterparties, at the latest, at the moment in which a non-centrally cleared OTC derivative contract is concluded, including the terms of the netting agreement and the terms of the exchange of collateral agreement in accordance with Article 3;

(h) the periodic verification of the liquidity of the collateral to be exchanged;

(i) the timely re-appropriation of the collateral in the event of default by the posting counterparty from the collecting counterparty; and

(j) the regular monitoring of the exposures arising from OTC derivative contracts that are intragroup transactions and the timely settlement of the obligations resulting from those contracts.

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For the purposes of point (g) of the first subparagraph, the terms of the agreements shall comprise all aspects concerning the obligations arising from any non-centrally cleared OTC derivative contract to be concluded, and at least the following:

(a) any payment obligations arising between counterparties;

(b) the conditions for netting payment obligations;

(c) events of default or other termination events of the non-centrally cleared OTC derivative contracts;

(d) all calculation methods used in relation to payment obligations;

(e) the conditions for netting payment obligations upon termination,

(f) the transfer of rights and obligations upon termination;

(g) the governing law of the transactions of the non-centrally cleared OTC derivative contracts.

3. Where counterparties enter into a netting or an exchange of collateral agreement, they shall perform an independent legal review of the enforceability of those agreements. That review may be conducted by an internal independent unit or by an independent third party.

The requirement to perform the review referred to in the first subparagraph shall be considered to be satisfied in relation to the netting agreement where that agreement is recognised in accordance with Article 296 of Regulation (EU) No 575/2013.

4. Counterparties shall establish policies to assess on a continuous basis the enforceability of the netting and the exchange of collateral agreements that they enter into.

5. The risk management procedures referred to in paragraph 1 shall be tested, reviewed and updated as necessary and at least annually.

6. Upon request, counterparties using initial margin models in accordance with Section 4 shall provide the competent authorities with any documentation relating to the risk management procedures referred to in paragraph 2(b) at any time.

Article 3
Exchange of collateral agreement

1. The exchange of collateral agreement referred to in point (g) of the first subparagraph of Article 2(2) shall include at least the following terms:

(a) the levels and type of collateral required;

(b) the segregation arrangements;

(c) the netting set to which the exchange of collateral refers;

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(d) the procedures for notification, confirmation and adjustment of margin calls;

(e) the procedures for settlement of margin calls for each type of eligible collateral;

(f) the procedures, methods, timeframes and allocation of responsibilities for the calculation of margins and the valuation of collateral;

(g) the events that are considered to be default or termination events;

(h) the law applicable to the non-centrally cleared OTC derivative contract;

(i) the law applicable to the exchange of collateral agreement.

SECTION 2
ELIGIBILITY

Article 4
Eligible collateral

1. A counterparty shall only collect collateral from the following asset classes:

(a) cash in the form of money credited to an account in any currency, or similar claims for the repayment of money, such as money market deposits;

(b) gold in the form of allocated pure gold bullion of recognised good delivery;

(c) debt securities issued by Member States' central governments or central banks;

(d) debt securities issued by Member States’ regional governments or local authorities whose exposures are treated as exposures to the central government of that Member State in accordance with Article 115(2) of Regulation (EU) No 575/2013;

(e) debt securities issued by Member States’ public sector entities whose exposures are treated as exposures to the central government, regional government or local authority of that Member State in accordance with Article 116(4) of Regulation (EU) No 575/2013;

(f) debt securities issued by Member States’ regional governments or local authorities other than those referred to in point (d);

(g) debt securities issued by Member States’ public sector entities other than those referred to in point (e);

(h) debt securities issued by multilateral development banks listed in Article 117(2) of Regulation (EU) No 575/2013;

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(i) debt securities issued by the international organisations listed in Article 118 of Regulation (EU) No 575/2013;

(j) debt securities issued by third countries' governments or central banks;

(k) debt securities issued by third countries' regional governments or local authorities that meet the requirements of points (d) and (e);

(l) debt securities issued by third countries' regional governments or local authorities other than those referred to in points (d) and (e);

(m) debt securities issued by credit institutions or investment firms including bonds referred to in Article 52(4) of Directive 2009/65/EC of the European Parliament and of the Council[9];

(n) corporate bonds;

(o) the most senior tranche of a securitisation, as defined in Article 4(61) of Regulation (EU) No 575/2013, that is not a re-securitisation as defined in Article 4(63) of that Regulation;

(p) convertible bonds provided that they can be converted only into equities which are included in an index specified pursuant to point (a) of Article 197 (8) of Regulation (EU) No 575/2013;

(q) equities included in an index specified pursuant to point (a) of Article 197(8) of Regulation (EU) No 575/2013;

(r) shares or units in undertakings for collective investments in transferable securities (UCITS), provided that the conditions set out in Article 5 are met.

2. A counterparty shall only collect collateral from the asset classes referred to in points (f), (g) and (k) to (r) of paragraph 1 where all the following conditions apply:

(a) the assets are not issued by the posting counterparty;

(b) the assets are not issued by entities which are part of the group to which the posting counterparty belongs;

(c) the assets are not otherwise subject to any significant wrong way risk, as defined in points (a) and (b) of paragraph 1 of Article 291 of Regulation (EU) No 575/2013.

[9] Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS)

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Article 5
Eligibility criteria for units or shares in UCITS

1. For the purposes of point (r) of Article 4(1), a counterparty may only use units or shares in UCITS as eligible collateral where all the following conditions are met:

(a) the units or shares have a daily public price quote;

(b) the UCITS are limited to investing in assets that are eligible in accordance with Article 4(1);

(c) the UCITS meet the criteria laid down in Article 132(3) of Regulation (EU) No 575/2013.

For the purposes of point (b), UCITS may use derivative instruments to hedge the risks arising from the assets in which they invest.

Where a UCITS invests in shares or units of other UCITS, the conditions laid down in the first subparagraph shall also apply to those UCITS.

2. By way of derogation from point (b) of paragraph 1, where a UCITS or any of its underlying UCITS do not only invest in assets that are eligible in accordance with Article 4(1), only the value of the unit or share of the UCITS that represents investment in eligible assets may be used as eligible collateral pursuant to paragraph 1 of this Article

The first subparagraph shall apply to any underlying UCITS of a UCITS that has underlying UCITS of its own.

3. Where non-eligible assets of a UCITS can have a negative value, the value of the unit or share of the UCITS that may be used as eligible collateral pursuant to paragraph 1 shall be determined by deducting the maximum negative value of the non-eligible assets from the value of eligible assets.

Article 6
Credit quality assessment

1. The collecting counterparty shall assess the credit quality of assets belonging to the asset classes referred to in points (c), (d) and (e) of Article 4(1) that are either not denominated or not funded in the issuer’s domestic currency and in points (f), (g), (j) to (n) and (p) of Article 4(1) using one of the following methodologies:

(a) the internal ratings referred to in paragraph 3 of the collecting counterparty;

(b) the internal ratings referred to in paragraph 3 of the posting counterparty, where that counterparty is established in the Union or in a third country where the posting counterparty is subject to consolidated supervison assessed equivalent to that governed by Union law in accordance with Article 127 of Directive 2013/36/EU;

(c) a credit quality assessment issued by a recognised External Credit Assessment Institution (ECAI) as defined in Article 4(98) of Regulation (EU) No 575/2013

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or a credit quality assessment of an export credit agency referred to in Article 137 of that Regulation.

2. The collecting counterparty shall assess the credit quality of assets belonging to the asset class referred to in point (o) of Article 4(1) using the methodology referred to in point (c) of paragraph 1 of this Article.

3. A counterparty permitted to use the Internal Rating Based (IRB) approach pursuant to Article 143 of Regulation (EU) No 575/2013 may use their internal ratings in order to assess the credit quality of the collateral collected for the purposes of this Regulation.

4. A counterparty using the IRB approach in accordance with paragraph 3 shall determine the credit quality step of the collateral in accordance with Annex I.

5. A counterparty using the IRB approach in accordance with paragraph 3 shall communicate to the other counterparty the credit quality step referred to in paragraph 4 associated to the assets to be exchanged as collateral.

6. For the purposes of paragraphs 1(c), the credit quality assessment shall be mapped to credit quality steps specified pursuant to Articles 136 or 270 of Regulation (EU) No 575/2013.

Article 7
Specific requirements for eligible assets

1. Counterparties shall only use the assets referred to in points (f), (g) and (j) to (p) of Article 4(1) as collateral where their credit quality has been assessed as credit quality steps 1, 2 or 3 in accordance with Article 6.

2. Counterparties shall only use the assets referred to in points (c), (d) and (e) of Article 4(1) that are not denominated or funded in the issuer's domestic currency as collateral where their credit quality has been assessed as credit quality steps 1, 2, 3 or 4 in accordance with Article 6.

3. Counterparties shall establish procedures for the treatment of assets exchanged as collateral in accordance with paragraphs 1 and 2 whose credit quality is subsequently assessed to be:

(a) step 4 or beyond for assets referred to in paragraph 1;

(b) beyond step 4 for assets referred to in paragraph 2.

4. The procedures referred to in paragraph 3 shall meet all of the following requirements:

(a) they shall prohibit counterparties from exchanging additional assets assessed to be of the credit quality referred to in paragraph 3;

(b) they shall establish a schedule by which assets assessed to be of the credit quality referred to in paragraph 3 and already exchanged as collateral are replaced over a period of time not exceeding two months;

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(c) they shall set a credit quality step that requires the immediate replacement of the assets referred to in paragraph 3;

(d) they shall allow counterparties to increase the haircuts on the relevant collateral insofar as the collateral has not been replaced in accordance with the schedule referred to in point (b).

5. Counterparties shall not use assets classes referred to in Article 4(1) as collateral where they have no access to the market for those assets or where they are unable to liquidate those assets in a timely manner in case of default of the posting counterparty.

Article 8
Concentration limits for initial margin

1. Where collateral is collected as initial margin in accordance with Article 13, the following limits shall apply for each collecting counterparty:

(a) the sum of the values of the initial margin collected from the asset classes referred to in points (b), (f), (g), and (l) to (r) of Article 4(1) issued by a single issuer or by entities which belong to the same group does not exceed the greater of the following values:

(i) 15% of the collateral collected from the posting counterparty;

(ii) EUR 10 million or the equivalent in another currency;

(b) the sum of the values of the initial margin collected from the asset classes referred to in points (o), (p) and (q) of Article 4(1), where the asset classes referred to in points (p) and (q) of that Article are issued by institutions as defined in Regulation (EU) No 575/2013, does not exceed the greater of the following values:

(i) 40% of the collateral collected from the posting counterparty;

(ii) EUR 10 million or the equivalent in another currency.

The limits laid down in the first subparagraph shall also apply to shares or units in UCITS where the UCITS primarily invests in the asset classes referred to in that subparagraph.

2. Where collateral is collected as initial margin in accordance with Article 13 in excess of EUR 1 billion and each of the counterparties belong to one of the categories listed in paragraph 3, the following limits to the amount of initial margin in excess of EUR 1 billion collected from a counterparty shall apply:

(a) the sum of the values of the initial margin collected from the asset classes referred to in points (c) to (l) of Article 4(1) issued by a single issuer or by issuers domiciled in the same country shall not exceed 50% of the initial margin collected from that counterparty.

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(b) Where initial margin is collected in cash, the 50% concentration limit referred to in point (a) shall also take into account the risk exposures arising from the third party holder or custodian holding that cash.

3. The counterparties referred to in paragraph 2 shall be one of the following:

(a) institutions identified as G-SIIs in accordance with Article 131 of Directive 2013/36/EU;

(b) institutions identified as O-SIIs in accordance with Article 131 of Directive 2013/36/EU;

(c) counterparties which are not pension scheme arrangements and for which the sum of the values of the collateral to be collected exceeds EUR 1 billion.

4. Where collateral is collected as initial margin in accordance with Article 13 in excess of EUR 1 billion by or from a pension scheme arrangement, the collecting counterparty shall establish procedures to manage concentration risk with respect to collateral collected from the asset classes referred to in points (c) to (l) of Article 4(1), including adequate diversification of that collateral.

5. Where institutions referred to in points (a) and (b) of paragraph 3 collect initial margin in cash from a single counterparty that is also an institution referred to in those points, the collecting counterparty shall ensure that not more than 20% of that initial margin is held by a single third party custodian.

6. Paragraphs 1 to 4 shall not apply to collateral collected in the form of financial instruments that are the same as the underlying financial instrument of the non-centrally cleared OTC derivative contract.

7. The collecting counterparty shall assess compliance with the conditions laid down in paragraph 2 of this Article at least every time that initial margin is calculated in accordance with Article 9(2).

8. By way of derogation from paragraph 7, a counterparty referred to in points (a), (b) and (c) of Article 2(10) of Regulation (EU) No 648/2012 may assess compliance with the conditions laid down in paragraph 2 quarterly, provided that the amount of initial margin collected from each individual counterparty is at all times below EUR 800 million during the quarter preceding the assessment.

SECTION 3
CALCULATION AND COLLECTION OF MARGINS

Article 9
Frequency of calculation and determination of the calculation date

1. Counterparties shall calculate variation margin in accordance with Article 10 at least on a daily basis.

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2. Counterparties shall calculate initial margin in accordance with Article 11 no later than the business day following one of these events:

(a) where a new non-centrally cleared OTC derivative contract is executed or added to the netting set;

(b) where an existing non-centrally cleared OTC derivative contract expires or is removed from the netting set;

(c) where an existing non-centrally cleared OTC derivative contract triggers a payment or a delivery other than the posting and collecting of margins;

(d) where the initial margin is calculated in accordance with the standardised approach referred to in Article 11(1) and an existing contract is reclassified in terms of the asset category referred to in paragraph 1 of Annex IV as a result of reduced time to maturity;

(e) where no calculation has been performed in the preceding ten business days.

3. For the purpose of determining the calculation date for initial and variation margin, the following shall apply:

(a) where two counterparties are located in the same time-zone, the calculation shall be based on the netting set of the previous business day;

(b) where two counterparties are not located in the same time-zone, the calculation shall be based on the transactions in the netting set which are entered into before 16:00 hours of the previous business day of the time-zone where it is first 16:00 hours.

Article 10
Calculation of variation margin

The amount of variation margin to be collected by a counterparty shall be the aggregation of the values calculated in accordance with Article 11(2) of Regulation (EU) No 648/2012 of all contracts in the netting set, minus the value of all variation margin previously collected, minus the net value of each contract in the netting set at the point of entry into the contract, and plus the value of all variation margin previously posted.

Article 11
Calculation of initial margin

1. Counterparties shall calculate the amount of initial margin to be collected using either the standardised approach set out in Annex IV or the initial margin models referred to in Section 4 or both.

2. The collection of initial margin shall be performed without offsetting the initial margin amounts between the two counterparties.

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3. Where counterparties use both the standardised approach set out in Annex IV and the initial margin models referred to in Section 4 in relation to the same netting set, they shall use them consistently for each non-centrally cleared OTC derivative contract.

4. Counterparties calculating the initial margin in accordance with Section 4 shall not take into account any correlations between the value of the unsecured exposure and the collateral in that calculation.

5. Counterparties shall agree on the method each counterparty uses to determine the initial margin it has to collect but are not required to use a common methodology.

6. Where one or both counterparties rely on an initial margin model they shall agree on the model developed pursuant to Section 4.

Article 12
Provision of variation margin

1. The posting counterparty shall provide the variation margin as follows:

   (a) within the same business day of the calculation date determined in accordance with Article 9(3);

   (b) where the conditions in paragraph 2 are met, within two business days of the calculation date determined in accordance with Article 9(3).

2. The provision of variation margin in accordance with paragraph 1(b) may only be applied to the following:

   (a) netting sets comprising derivative contracts not subject to initial margin requirements in accordance with this Regulation, where the posting counterparty has provided, at or before the calculation date of the variation margin, an advance amount of eligible collateral calculated in the same manner as that applicable to initial margins in accordance with Article 15, for which the collecting counterparty has used a margin period of risk ('MPOR') at least equal to the number of days in between and including the calculation date and the collection date;

   (b) netting sets comprising contracts subject to initial margin requirements in accordance with this Regulation, where the initial margin has been adjusted in one of the following ways:

      (i) by increasing the MPOR referred to in Article 15(2) by the number of days in between, and including, the calculation date determined in accordance with Article 9(3) and the collection date determined in accordance with paragraph 1 of this Article;

      (ii) by increasing the initial margin calculated in accordance with the standardised approach referred to in Article 11 using an appropriate methodology taking into account a MPOR that is increased by the number of days in between, and including, the calculation date determined in accordance with Article 9(3) and the collection date determined in accordance with paragraph 2 of this Article.

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For the purposes of point (a), in case no mechanism for segregation is in place between the two counterparties, those countarparties may offset the amounts to be provided.

3. In the event of a dispute over the amount of variation margin due, counterparties shall provide, in the same time frame referred to in paragraph 1, at least the part of the variation margin amount that is not being disputed.

Article 13
Provision of initial margin

1. The posting counterparty shall provide the initial margin in accordance with Section 5.

2. The posting counterparty shall provide the initial margin within the same business day of the calculation date determined in accordance with Article 9(3).

3. In the event of a dispute over the amount of initial margin due, counterparties shall provide at least the part of the initial margin amount that is not being disputed within the same business day of the calculation date determined in accordance with Article 9(3).

SECTION 4
INITIAL MARGIN MODELS

Article 14
General requirements

1. Where a counterparty uses an initial margin model, that model may be developed by any of, or both, counterparties or by a third party agent.

Where a counterparty uses an initial margin model developed by a third party agent, the counterparty shall remain responsible for ensuring that that model complies with the requirements referred to in this Section.

2. Initial margin models shall be developed in a way that captures all the significant risks arising from entering into the non-centrally cleared OTC derivative contracts included in the netting set, including the nature, scale, and complexity of those risks and shall meet the following requirements:

(a) the model incorporates risk factors corresponding to the individual currencies in which those contracts in the netting set are denominated;

(b) the model incorporates interest rate risk factors corresponding to the individual currencies in which those contracts are denominated;

(c) the yield curve is divided into a minimum of six maturity buckets for exposures to interest-rate risk in the major currencies and markets;

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(d) the model captures the risk of movements between different yield curves and between different maturity buckets;

(e) the model incorporates separate risk factors at least for each equity, equity index, commodity or commodity index which is significant for those contracts;

(f) the model captures the risk arising from less liquid positions and positions with limited price transparency within realistic market scenarios;

(g) the model captures the risk, otherwise not captured by other features of the model, arising from derivative contracts where the underlying asset class is credit;

(h) the model captures the risk of movements between similar, but not identical, underlying risk factors and the exposure to changes in values arising from maturity mismatches;

(i) the model captures main non-linear dependencies;

(j) the model incorporates methodologies used for back-testing which include statistical tests of the model's performance;

(k) the model determines which events trigger a model change, calibration or other remedial action.

3. The risk management procedures referred to in Article 2(1) shall ensure that the performance of the model is monitored on a continuous basis including by back-testing the model at least every three months.

For the purposes of the first subparagraph, back testing shall include a comparison between the values produced by the model and the realized market values of the non-centrally cleared OTC derivative contracts in the netting set.

4. The risk management procedures referred to in Article 2(1) shall outline the methodologies used for undertaking back-testing, including statistical tests of performance.

5. The risk management procedures referred to in Article 2(1) shall describe what results of the back-testing would lead to a model change, recalibration or other remediation action.

6. The risk management procedures referred to in Article 2(1) shall ensure that counterparties retain records of the results of the back-testing referred to in paragraph 3 of this Article.

7. Counterparties shall provide all the information necessary to explain the calculation of a given value of the initial margin model to the other counterparty in a way that a knowledgeable third party would be able to verify that calculation.

8. The initial margin model shall reflect parameter uncertainty, correlation, basis risk and data quality in a prudent manner.

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Article 15
Confidence interval and MPOR

1. The assumed variations in the value of the non-centrally cleared OTC derivative contracts within the netting set for the calculation of initial margins using an initial margin model shall be based on a one-tailed 99 percent confidence interval over a MPOR of at least 10 days.

2. The MPOR for the calculation of initial margins using an initial margin model referred to in paragraph 1 shall include:

(a) the period that may elapse from the last margin exchange of variation margin to the default of the counterparty;

(b) the estimated period needed to replace each of the non-centrally cleared OTC derivative contracts within the netting set or hedge the risks arising from them, taking into account the level of liquidity of the market where those types of contracts are traded, the total volume of the non-centrally cleared OTC derivative contracts in that market and the number of participants in that market.

Article 16
Calibration of the parameters of the model

1. Parameters used in initial margin models shall be calibrated, at least annually, based on historical data from a time period with a minimum duration of three years and a maximum duration of five years.

2. The data used for calibrating the parameters of initial margin models shall include the most recent continuous period from the date on which the calibration referred to in paragraph 1 is performed and at least 25% of those data shall be representative of a period of significant financial stress ('stressed data').

3. Where stressed data referred to in paragraph 2 does not constitute at least 25% of the data used in the initial margin model, the least recent data of the historical data referred to in paragraph 1 shall be replaced by data from a period of significant financial stress, until the overall proportion of stressed data is at least 25% of the overall data used in the initial margin model.

4. The period of significant financial stress used for calibration of the parameters shall be identified and applied separately at least for each of the asset classes referred to in Article 4(1).

5. The parameters shall be calibrated using equally weighted data.

6. The parameters may be calibrated for shorter periods than the MPOR determined in accordance with Article 15. Where shorter periods are used, the parameters shall be adjusted to that MPOR by an appropriate methodology.

7. Counterparties shall have written policies setting out the circumstances triggering a more frequent calibration.

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8. Counterparties shall establish procedures for adjusting the value of the margins to be exchanged in response to a change in the parameters due to a change in market conditions. Those procedures shall provide for counterparties to be able to exchange the additional initial margin resulting from that change of the parameters over a period that ranges between one and thirty business days.

9. Counterparties shall establish procedures regarding the quality of the data used in the model in accordance with paragraph 1, including the selection of appropriate data providers and the cleaning and interpolation of that data.

10. Proxies for the data used in initial margin models shall be used only where both of the following conditions are met:

(a) available data is insufficient or is not reflective of the true volatility of an OTC derivative contract or portfolio of OTC derivative contracts within the netting set;

(b) the proxies lead to a conservative level of margins.

Article 17
Diversification, hedging and risk offsets across underlying classes

1. Initial margin models shall only include non-centrally cleared OTC derivative contracts within the same netting set. Initial margin models may provide for diversification, hedging and risk offsets arising from the risks of the contracts within the same netting set, provided that the diversification, hedging or risk offset is only carried out within the same underlying asset class as referred to in paragraph 2.

2. For the purposes of paragraph 1, diversification, hedging and risk offsets may only be carried out within the following underlying asset classes:

(a) interest rates, currency and inflation;

(b) equity;

(c) credit;

(d) commodities and gold;

(e) other.

Article 18
Qualitative requirements

1. Counterparties shall establish an internal governance process to assess the appropriateness of the initial margin model on a continuous basis, including all of the following:

(a) an initial validation of the model by suitably qualified persons who are independent from the persons developing the model;

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(b) a follow up validation whenever a significant change is made to the initial margin model and at least annually;

(c) a regular audit process to assess the following:

(i) the integrity and reliability of the data sources;

(ii) the management information system used to run the model;

(iii) the accuracy and completeness of data used;

(iv) the accuracy and appropriateness of volatility and correlation assumptions.

2. The documentation of the risk management procedures referred to in point (b) of Article 2(2) relating to the initial margin model shall meet all of the following conditions:

(a) it shall allow a knowledgeable third-party to understand the design and operational detail of the initial margin model;

(b) it shall contain the key assumptions and the limitations of the initial margin model;

(c) it shall define the circumstances under which the assumptions of the initial margin model are no longer valid.

3. Counterparties shall document all changes to the initial margin model. That documentation shall also detail the results of the validations, referred to in paragraph 1, carried out after those changes.

SECTION 5
COLLATERAL MANAGEMENT AND SEGREGATION

Article 19
Collateral management and segregation

1. The procedures referred to in Article 2(2)(c) shall include the following:

(a) a daily valuation of the collateral held in accordance with Section 6;

(b) the legal arrangements and a collateral holding structure that allow access to the received collateral where it is being held by a third party;

(c) where initial margin is held by the collateral provider, that the collateral is held in insolvency-remote custody accounts;

(d) that non-cash initial margin is maintained in accordance with paragraphs 3 and 4;

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(e) that cash collected as initial margin is maintained in cash accounts at central banks or credit institutions which fulfil all of the following conditions:

   (i) they are authorised in accordance with Directive 2013/36/EU or are authorised in a third country whose supervisory and regulatory arrangements have been found to be equivalent in accordance with Article 142(2) of Regulation (EU) No 575/2013;

   (ii) they are neither the posting nor the collecting counterparties, nor part of the same group as either of the counterparties;

(f) the availability of unused collateral to the liquidator or other insolvency official of the defaulting counterparty;

(g) the initial margin is freely transferable to the posting counterparty in a timely manner in case of the default of the collecting counterparty;

(h) that non-cash collateral is transferable without any regulatory or legal constraints or third party claims, including those of the liquidator of the collecting counterparty or third party custodian, other than liens for fees and expenses incurred in providing the custodial accounts and other than liens routinely imposed on all securities in a clearing system in which such collateral may be held;

(i) that any unused collateral is returned to the posting counterparty in full, excluding costs and expenses incurred for the process of collecting and holding the collateral.

2. Any collateral posted as initial or variation margin may be substituted by alternative collateral where all of the following conditions are met:

   (a) the substitution is made in accordance with the terms of the agreement between the counterparties referred to in Article 3;

   (b) the alternative collateral is eligible in accordance with Section 2;

   (c) the value of the alternative collateral is sufficient to meet all margin requirements after applying any relevant haircut.

3. Initial margin shall be protected from the default or insolvency of the collecting counterparty by segregating it in either or both of the following ways:

   (a) on the books and records of a third party holder or custodian;

   (b) via other legally binding arrangements;

4. Counterparties shall ensure that non-cash collateral exchanged as initial margin is segregated as follows:

   (a) where collateral is held by the collecting counterparty on a proprietary basis, it shall be segregated from the rest of the proprietary assets of the collecting counterparty;

(b) where collateral is held by the posting counterparty on a non proprietary basis, it shall be segregated from the rest of the proprietary assets of the posting counterparty;

(c) where collateral is held on the books and records of a custodian or other third party holder, it shall be segregated from the proprietary assets of that third-party holder or custodian.

5. Where non-cash collateral is held by the collecting party or by a third party holder or custodian, the collecting counterparty shall always provide the posting counterparty with the option to segregate its collateral from the assets of other posting counterparties.

6. Counterparties shall perform an independent legal review in order to verify that the segregation arrangements meet the requirements referred to in paragraph 1(g) and paragraphs 3, 4 and 5. That legal review may be conducted by an independent internal unit, or by an independent third party.

7. Counterparties shall provide evidence to their competent authorities of compliance with paragraph 6 in relation to each relevant jurisdiction and, upon request by a competent authority, shall establish policies ensuring the continuous assessment of compliance.

8. For the purposes of paragraph 1(e), the counterparties shall assess the credit quality of the credit institution referred to therein by using a methodology that does not solely or mechanistically rely on external credit quality assessments.

Article 20
Treatment of collected initial margins

1. The collecting counterparty shall not rehypothecate, repledge nor otherwise reuse the collateral collected as initial margin.

2. Notwithstanding paragraph 1, a third party holder may use the initial margin received in cash for reinvestment purposes.

SECTION 6
VALUATION OF COLLATERAL

Article 21
Calculation of the adjusted value of collateral

1. Counterparties shall adjust the value of collected collateral in accordance with either the methodology set out in Annex II or a methodology using own volatility estimates accordance with Article 22.

2. When adjusting the value of collateral pursuant to paragraph 1, counterparties may disregard the foreign exchange risk arising from positions in currencies which are

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subject to a legally binding intergovernmental agreement limiting the variation of those positions relative to other currencies covered by the same agreement.

Article 22

Own estimates of the adjusted value of collateral

1. Counterparties shall adjust the value of collected collateral using own volatility estimates in accordance with Annex III.

2. Counterparties shall update their data sets and calculate the own volatility estimates referred to in Article 21 whenever the level of market prices' volatility changes materially and at least quarterly.

3. For the purposes of paragraph 2, counterparties shall pre-determine the levels of volatility that trigger a recalculation of the haircuts as referred to in Annex III.

4. The procedures referred to in Article 2(2)(d) shall include policies to monitor the calculation of the own volatility estimates and the integration of those estimates into the risk management process of that counterparty.

5. The policies referred to in paragraph 4 shall be subject to an internal review that includes all of the following:

   (a) the integration of the estimates into the risk management process of the counterparty, which shall take place at least annually;

   (b) the integration of estimated haircuts into daily risk management;

   (c) the validation of any significant change in the process for the calculation of the estimates;

   (d) the verification of the consistency, timeliness and reliability of data sources used to calculate the estimates;

   (e) the accuracy and appropriateness of the volatility assumptions.

6. The review referred to in paragraph 5 shall be carried out regularly within the internal auditing process of the counterparty.

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CHAPTER II

Specific Provisions on Risk Management Procedures

SECTION 1
EXEMPTIONS

Article 23
CCPs authorized as credit institutions

By way of derogation from Article 2(2), counterparties may provide in their risk management procedures that no collateral is exchanged in relation to non-centrally cleared OTC derivative contracts entered into with CCPs authorised as credit institutions in accordance with Directive 2013/36/EU.

Article 24
Non-financial counterparties and third country counterparties

By way of derogation from Article 2(2), counterparties may provide in their risk management procedures that no collateral is exchanged in relation to non-centrally cleared OTC derivative contracts entered into with non-financial counterparties that do not meet the conditions of Article 10(1)(b) of Regulation (EU) No 648/2012, or with non-financial entities established in a third country that would not meet the conditions of Article 10(1)(b) of Regulation (EU) No 648/2012 if they were established in the Union.

Article 25
Minimum transfer amount

1. By way of derogation from Article 2(2), counterparties may provide in their risk management procedures that no collateral is collected from a counterparty where the amount due from the last collection of collateral is equal to or lower than the amount agreed by the counterparties ('minimum transfer amount').

   The minimum transfer amount shall not exceed EUR 500 000 or the equivalent amount in another currency.

2. Where counterparties agree on a minimum transfer amount, the amount of collateral due shall be calculated as the sum of:

   (a) the variation margin due from its last collection calculated in accordance with Article 10, including any excess collateral;

   (b) the initial margin due from its last collection calculated in accordance with Article 11, including any excess collateral;

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3. Where the amount of collateral due exceeds the minimum transfer amount agreed by the counterparties, the collecting counterparty shall collect the full amount of collateral due without deduction of the minimum transfer amount.

4. Counterparties may agree on separate minimum transfer amounts for initial and variation margins, provided that the sum of those minimum transfer amounts is equal to or lower than EUR 500 000 or the equivalent amount in another currency.

5. Where counterparties agree on separate minimum transfer amounts in accordance with paragraph 4, the collecting counterparty shall collect the full amount of initial or variation margin due without any deduction of those minimum transfer amounts where the amount of initial or variation collateral due exceeds the minimum transfer amount.

Article 26
Margin calculation with third country counterparties

Where a counterparty is domiciled in a third country, counterparties may calculate margins on the basis of a netting set that includes the following types of contracts:

(a) non-centrally cleared OTC derivatives subject to margin requirements under this Regulation;

(b) contracts that meet both of the following conditions*:*

(i) they are identified as non-centrally cleared OTC derivatives by the regulatory regime applicable to the counterparty domiciled in the third-country;

(ii) they are subject to margin rules in the regulatory regime applicable to the counterparty domiciled in the third-country.

SECTION 2
EXEMPTIONS IN CALCULATING LEVELS OF INITIAL MARGIN

Article 27
Foreign exchange contracts

By way of derogation from Article 2(2), counterparties may provide in their risk management procedures that initial margins are not collected with respect to:

(a) physically settled OTC derivative contracts that solely involve the exchange of two different currencies on a specific future date at a fixed rate agreed on the trade date of the contract covering the exchange (‘foreign exchange forwards’);

(b) physically settled OTC derivative contracts that solely involve an exchange of two different currencies on a specific date at a fixed rate that is agreed on the

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trade date of the contract covering the exchange, and a reverse exchange of the two currencies at a later date and at a fixed rate that is also agreed on the trade date of the contract covering the exchange ('foreign exchange swaps');

(c) the exchange of principal of non-centrally cleared OTC derivative contracts under which counterparties exchange solely the principal amount and any interest payments in one currency for the principal amount and any interest payments in another currency, at specified points in time according to a specified formula ('currency swap').

Article 28
Threshold based on notional amount

1. By way of derogation from Article 2(2), counterparties may provide in their risk management procedures that initial margins are not collected for all new OTC derivative contracts entered into within a calendar year where one of the two counterparties has an aggregate month-end average notional amount of non-centrally cleared OTC derivatives for the months March, April and May of the preceding year of below EUR 8 billion.

The aggregate month-end average notional amount referred to in the first subparagraph shall be calculated at the counterparty level or at the group level where the counterparty belongs to a group.

2. Where a counterparty belongs to a group, the calculation of the group aggregate month-end average notional amount shall include all non-centrally cleared OTC derivative contracts of the group including all intragroup non-centrally cleared OTC derivatives contracts.

For the purposes of the first subparagraph, OTC derivative contracts which are internal transactions shall only be taken into account once.

3. UCITS authorised in accordance with Directive 2009/65/EC and alternative investment funds managed by alternative investment fund managers authorised or registered in accordance with Directive 2011/61/EU of the European Parliament and of the Council[10] shall be considered distinct entities and treated separately when applying the thresholds referred to in paragraph 1 where the following conditions are met:

(a) the funds are distinct segregated pools of assets for the purposes of the fund's insolvency or bankruptcy;

(b) the segregated pools of assets are not collateralised, guaranteed or otherwise financially supported by other investment funds or their managers.

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[10] Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 (OJ, L 174, 1.7.2011, p.1).

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Article 29
Threshold based on initial margin amounts

1. By way of derogation from Article 2(2), counterparties may provide in their risk management procedures that initial margin collected is reduced by an amount up to EUR 50 million in the case of points (a) and (b) of this paragraph or EUR 10 million in the case of point (c) where:

   (a) neither counterparty belongs to any group;

   (b) the counterparties are part of different groups;

   (c) both counterparties belong to the same group.

2. Where a counterparty does not collect initial margins in accordance with paragraph 1(b), the risk management procedures referred to in Article 2(1) shall include provisions on monitoring, at group level, whether that threshold is exceeded and provisions for the retention of appropriate records of the group's exposures to each single counterparty in the same group.

3. UCITS authorised in accordance with Directive 2009/65/EC and alternative investment funds managed by alternative investment fund managers authorised or registered in accordance with Directive 2011/61/EU of the European Parliament and of the Council shall be considered distinct entities and treated separately when applying the thresholds referred to in paragraph 1 where the following conditions are met:

   (a) the funds are distinct segregated pools of assets for the purposes of the fund's insolvency or bankruptcy;

   (b) the segregated pools of assets are not collateralised, guaranteed or otherwise financially supported by other investment funds or their managers.

SECTION 3
EXEMPTIONS FROM THE REQUIREMENT TO POST OR COLLECT INITIAL OR VARIATION MARGIN

Article 30
Treatment of derivatives associated to covered bonds for hedging purposes

1. By way of derogation from Article 2(2) and where the conditions set out in paragraph 2 of this Article are met, counterparties may, in their risk management procedures, provide the following in relation to OTC derivative contracts concluded in connection with covered bonds:

   (a) variation margin is not posted by the covered bond issuer or cover pool but is collected from its counterparty in cash and returned to its counterparty when due;

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(b) initial margin is not posted or collected.

2. Paragraph 1 applies where all of the following conditions are met:

(a) the OTC derivative contract is not terminated in case of resolution or insolvency of the covered bond issuer or cover pool;

(b) the counterparty to the OTC derivative concluded with covered bond issuers or with cover pools for covered bonds ranks at least pari passu with the covered bond holders except where the counterparty to the OTC derivative concluded with covered bond issuers or with cover pools for covered bonds is the defaulting or the affected party, or waives the pari passu rank;

(c) the OTC derivative contract is registered or recorded in the cover pool of the covered bond in accordance with national covered bond legislation;

(d) the OTC derivative contract is used only to hedge the interest rate or currency mismatches of the cover pool in relation to the covered bond;

(e) the netting set does not include OTC derivative contracts unrelated to the cover pool of the covered bond;

(f) the covered bond to which the OTC derivative contract is associated meets the requirements of paragraphs (1), (2) and (3) of Article 129 of Regulation (EU) No 575/2013;

(g) the cover pool of the covered bond to which the OTC derivative contract is associated is subject to a regulatory collateralisation requirement of at least 102%.

Article 31
Treatment of derivatives with counterparties in third countries where legal enforceability of netting agreements or collateral protection cannot be ensured

1. By way of derogation from Article 2(2), counterparties established in the Union may provide in their risk management procedures that variation and initial margins are not required to be posted for non-centrally cleared OTC derivative contracts concluded with counterparties established in a third-country for which any of the following apply:

(a) the legal review referred to in Article 2(3) confirms that the netting agreement and, where used, the exchange of collateral agreement cannot be legally enforced with certainty at all times;

(b) the legal review referred to in Article 19(6) confirms that the segregation requirements referred to in Article 19(3), (4) and (5) cannot be met.

For the purposes of the first subparagraph, counterparties established in the Union shall collect margin on a gross basis.

2. By way of derogation from Article 2(2), counterparties established in the Union may provide in their risk management procedures that variation and initial margins are not

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required to be posted or collected for contracts concluded with counterparties established in a third-country where all of the following conditions apply:

(a) points (a) and, where applicable, point (b) of paragraph 1 apply;

(b) the legal reviews referred to in points (a) and (b) of paragraph 1 confirm that collecting collateral in accordance with this Regulation is not possible, even on a gross basis;

(c) the ratio calculated in accordance with paragraph 3 is lower than 2.5%.

3. The ratio referred to in paragraph 2(c) shall be the result of dividing the amount resulting from point (a) of this paragraph with that resulting from point (b):

(a) the sum of the notional amounts of any outstanding OTC derivative contracts of the group to which the counterparty belongs that were concluded after the entry into force of this Regulation and for which no margin has been collected from counterparties established in a third country for which point (b) of paragraph 2 applies;

(b) the sum of the notional amounts of all outstanding OTC derivative contracts of the group to which the counterparty belongs, excluding OTC derivative contracts that are intragroup transactions.

CHAPTER III

Intragroup derivative contracts

SECTION 1

PROCEDURES FOR COUNTERPARTIES AND COMPETENT AUTHORITIES WHEN APPLYING EXEMPTIONS FOR INTRAGROUP DERIVATIVE CONTRACTS

Article 32

Procedures for counterparties and relevant competent authorities

1. The application or notification from a counterparty to the competent authority pursuant to paragraphs 6 to 10 of Article 11 of Regulation (EU) No 648/2012 shall be deemed to have been received when the competent authority receives all of the following information:

(a) all the information necessary to assess whether the conditions specified in paragraphs 6, 7, 8, 9 or 10, respectively, of Article 11 of Regulation (EU) No 648/2012 have been fulfilled;

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(b) the information and documents referred to in Article 18(2) of Commission Delegated Regulation (EU) No 149/2013[11].

2. Where a competent authority determines that further information is required in order to assess whether the conditions referred to in paragraph 1(a) are fulfilled, it shall submit a written request for information to the counterparty.

3. A decision by a competent authority under Article 11(6) of Regulation (EU) No 648/2012 shall be communicated to the counterparty within three months of receipt of all the information referred to in paragraph 1.

4. Where a competent authority reaches a positive decision under paragraphs 6, 8, or 10 of Article 11 of Regulation (EU) No 648/2012, it shall communicate that positive decision to the counterparty in writing, specifying at least the following:

(a) whether the exemption is a full exemption or a partial exemption;

(b) in the case of a partial exemption, a clear identification of the limitations of the exemption.

5. Where a competent authority reaches a negative decision under paragraphs 6, 8, or 10 of Article 11 of Regulation (EU) No 648/2012 or objects to a notification under paragraphs 7 or 9 of Article 11 of that Regulation, it shall communicate that negative decision or objection to the counterparty in writing, specifying at least the following:

(a) the conditions of paragraphs 6, 7, 8, 9 or 10, respectively, of Article 11 of Regulation (EU) No 648/2012 that are not fulfilled;

(b) a summary of the reasons for considering that such conditions are not fulfilled.

6. Where one of the competent authorities notified under Article 11(7) of Regulation (EU) No 648/2012 considers that the conditions referred to in points (a) or (b) of the first subparagraph of Article 11(7) of that Regulation are not fulfilled, it shall notify the other competent authority within two months of receipt of the notification.

7. The competent authorities shall notify the non-financial counterparties of the objection referred to in paragraph 5 within three months of receipt of the notification.

8. A decision by a competent authority under Article 11(8) of Regulation (EU) No 648/2012 shall be communicated to the counterparty established in the Union within three months of receipt of all the information referred to in paragraph 1.

9. A decision by the competent authority of a financial counterparty referred to Article 11(10) of Regulation (EU) No 648/2012 shall be communicated to the competent authority of the non-financial counterparty within two months from the receipt of the

[11] Commission Delegated Regulation (EU) No 149/2013 of 19 December 2012 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on indirect clearing arrangements, the clearing obligation, the public register, access to a trading venue, non-financial counterparties, and risk mitigation techniques for OTC derivatives contracts not cleared by a CCP (OJ, L 52, 23.2.2013, p.11).

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all the information referred to in paragraph 1 and to the counterparties within three months of receipt of that information.

10. Counterparties that have submitted a notification or received a positive decision according to paragraphs 6, 7, 8, 9 or 10, respectively, of Article 11 of Regulation (EU) No 648/2012 shall immediately notify the relevant competent authority of any change that may affect the fulfilment of the conditions set out in those paragraphs, as applicable. The competent authority may object to the application for the exemption or withdraw its positive decision following any change in circumstances that could affect the fulfilment of those conditions.

11. Where a negative decision or objection is communicated by a competent authority, the relevant counterparty may only submit another application or notification where there has been a material change in the circumstances that formed the basis of the competent authority's decision or objection.

SECTION 2
APPLICABLE CRITERIA FOR APPLYING EXEMPTIONS FOR INTRAGROUP DERIVATIVE CONTRACTS

Article 33
Applicable criteria on the legal impediment to the prompt transfer of own funds and repayment of liabilities

A legal impediment to the prompt transfer of own funds or repayment of liabilities between the counterparties as referred to in paragraphs 5 to 10 of Article 11 of Regulation (EU) No 648/2012 shall be deemed to exist where there are actual or foreseen restrictions of a legal nature including any of the following:

(a) currency and exchange controls;

(b) a regulatory, administrative, legal or contractual framework that prevents mutual financial support or significantly affects the transfer of funds within the group;

(c) any of the conditions on the early intervention, recovery and resolution as referred to in Directive 2014/59/EU of the European Parliament and of the Council[12] are met, as a result of which the competent authority foresees an impediment to the prompt transfer of own funds or repayment of liabilities;

(d) the existence of minority interests that limit decision-making power within entities that form the group;

[12] 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 Council (OJ, L 173, 12.6.2014, p. 190).

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(e) the nature of the legal structure of the counterparty, as defined in its statutes, instruments of incorporation and internal rules.

Article 34

Applicable criteria on the practical impediments to the prompt transfer of own funds and repayment of liabilities

A practical impediment to the prompt transfer of own funds or repayment of liabilities between the counterparties as referred to in paragraphs 5 to 10 of Article 11 of Regulation (EU) No 648/2012 shall be deemed to exist where there are restrictions of a practical nature, including any of the following:

(a) insufficient availability of unencumbered or liquid assets to the relevant counterparty when due;

(b) impediments of an operational nature which effectively delay or prevent such transfers or repayments when due.

CHAPTER IV
Transitional and Final provisions

Article 35

Transitional provisions

Counterparties referred to in Article 11(3) of Regulation (EU) No 648/2012 may continue to apply the risk-management procedures that they have in place at the date of application of this Regulation in respect of non-centrally cleared OTC derivative contracts entered into between 16 August 2012 and the relevant dates of application of this Regulation.

Article 36

Application of 9(2), Article 11, Articles13 to 18, points (c), (d) and (f) of Article 19(1), Article 19(3) and Article 20

1. Article 9(2), Article 11, Articles 13 to 18, points (c), (d) and (f) of Article 19(1), Article 19(3) and Article 20 shall apply as follows:

(a) from one month after the date of entry into force of this Regulation, where both counterparties have, or belong to groups each of which has, an aggregate average notional amount of non-centrally cleared derivatives that is above EUR 3000 billion;

(b) from 1 September 2017, where both counterparties have, or belong to groups each of which has, an aggregate average notional amount of non-centrally cleared derivatives that is above EUR 2 250 billion;

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(c) from 1 September 2018, where both counterparties have, or belong to groups each of which has, an aggregate average notional amount of non-centrally cleared derivatives that is above EUR 1 500 billion;

(d) from 1 September 2019, where both counterparties have, or belong to groups each of which has, an aggregate average notional amount of non-centrally cleared derivatives that is above EUR 750 billion;

(e) from 1 September 2020, where both counterparties have, or belong to groups each of which has, an aggregate average notional amount of non-centrally cleared derivatives that is above EUR 8 billion.

2. By way of derogation from paragraph 1, where the conditions of paragraph 3 of this Article are met, Article 9(2), Article 11, Articles 13 to 18, points (c), (d) and (f) of Article 19(1), Article 19(3) and Article 20 shall apply as follows:

(a) 3 years after the date of entry into force of this Regulation where no equivalence decision has been adopted pursuant to Article 13(2) of Regulation (EU) No 648/2012 for the purposes of Article 11(3) of that Regulation in respect of the relevant third country;

(b) the later of the following dates where an equivalence decision has been adopted pursuant to Article 13(2) of Regulation (EU) No 648/2012 for the purposes of Article 11(3) of that Regulation in respect of the relevant third country:

(i) four months after the date of entry into force of the decision adopted pursuant to Article 13(2) of Regulation (EU) No 648/2012 for the purposes of Article 11(3) of that Regulation in respect of the relevant third country;

(ii) the applicable date determined pursuant to paragraph 3.

3. The derogation referred to in paragraph 2 shall only apply where counterparties to a non-centrally cleared OTC derivative contract meet all of the following conditions:

(a) one counterparty is established in a third country and the other counterparty is established in the Union;

(b) the counterparty established in a third country is either a financial counterparty or a non-financial counterparty;

(c) the counterparty established in the Union is one of the following:

(i) a financial counterparty, a non-financial counterparty, a financial holding company, a financial institution or an ancillary services undertaking subject to appropriate prudential requirements and the third country counterparty referred to in point (a) is a financial counterparty;

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(ii) either a financial counterparty or a non-financial counterparty and the third country counterparty referred to in point (a) is a non-financial counterparty;

(d) both counterparties are included in the same consolidation on a full basis in accordance to Article 3(3) of Regulation (EU) No 648/2012;

(e) both counterparties are subject to appropriate centralised risk evaluation, measurement and control procedures;

(f) the requirements of Chapter III are met.

Article 37
Application of Articles 9(1), 10 and 12

1. Articles 9(1), 10 and 12, shall apply as follows:

(a) from one month after the date of its entry into force of this Regulation for counterparties both of which have, or belong to groups each of which has, an aggregate average notional amount of non-centrally cleared OTC derivatives above EUR 3 000 billion;

(b) from the date that is the latest of 1 March 2017 or 1 month following the date of its entry into force of this Regulation for other counterparties.

2. By way of derogation from paragraph 1 in respect of contracts for foreign exchange forwards referred to in point (a) of Article 27, Articles 9(1), 10 and 12 shall apply on one of the following dates, whichever is earlier:

(a) 31 December 2018, where the Regulation referred to in point (b) does not yet apply;

(b) the date of entry into application of the Commission Delegated Regulation No [PO: please insert reference of Commission Delegated Regulation referred to in Article 4(2) of Directive 2014/65/EU] specifying some technical elements related to the definition of financial instruments with regard to physically settled foreign exchange forwards or the date determined pursuant to paragraph 1, whichever is later.

Article 38
Dates of application for specific contracts

1. By way of derogation from Articles 36(1) and 37, in respect of all non-centrally OTC derivatives which are single-stock equity options or index options, the Articles referred to in paragraph Articles 36(1) and 37 shall apply from 3 years after the date of entry into force of this Regulation.

2. By way of derogation from Articles 36(1) and 37, where a counterparty established in the Union enters into a non-cleared OTC derivative contract with another counterparty which belongs to the same group, the Articles referred to in Articles 36(1) and 37 shall apply from the dates specified in accordance with those Articles or

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[PO: please insert date: 6 months after the date of entry into force of this Regulation], whichever is the later.

Article 39
Calculation of aggregate average notional amount

1. For the purposes of Articles 36 and 37, the aggregate average notional amount referred to shall be calculated as the average of the total gross notional amount that meets all of the following conditions:

   (a) that are recorded on the last business day of March, April and May of 2016 with respect to counterparties referred to in point (a) of Article 36(1);

   (b) that are recorded on the last business day of March, April and May of the year referred to in each of the points in Article 36(1);

   (c) it includes all the entities of the group;

   (d) it includes all the non-centrally cleared OTC derivative contracts of the group;

   (e) it includes all the intragroup non-centrally cleared OTC derivative contracts of the group, counting each one of them once.

2. For the purpose of paragraph 1, UCITS authorised in accordance with Directive 2009/65/EC and alternative investment funds managed by alternative investment fund managers authorised or registered in accordance with Directive 2011/61/EU of the European Parliament and of the Council shall be considered distinct entities and treated separately, where the following conditions are met:

   (a) the funds are distinct segregated pools of assets for the purposes of the fund’s insolvency or bankruptcy;

   (b) the segregated pools of assets are not collateralised, guaranteed or otherwise financially supported by other investment funds or their managers.

Article 40
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.

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

Done at Brussels, 4.10.2016

For the Commission
The President
Jean-Claude JUNCKER

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