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COVER NOTE

From:	Secretary-General of the European Commission, signed by Mr Jordi AYET PUIGARNAU, Director
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To:	Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of the European Union

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Subject:	COMMISSION DELEGATED REGULATION (EU) .../... of 28.3.2019 amending Delegated Regulation (EU) 2016/2251 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council as regards the date until which counterparties may continue to apply their risk-management procedures for certain OTC derivative contracts not cleared by a CCP

Delegations will find attached document C(2019) 2530 final.

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

of 28.3.2019

amending Delegated Regulation (EU) 2016/2251 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council as regards the date until which counterparties may continue to apply their risk-management procedures for certain OTC derivative contracts not cleared by a CCP

(Text with EEA relevance)

EXPLANATORY MEMORANDUM

1. CONTEXT OF THE DELEGATED ACT

The United Kingdom submitted on 29 March 2017 the notification of its intention to withdraw from the Union pursuant to Article 50 of the Treaty on European Union. This meant that, if the Withdrawal Agreement¹ is not ratified, the Unions' primary and secondary law will cease to apply to the United Kingdom from 30 March 2019 ('the withdrawal date'). The United Kingdom will then become a third country. On 21 March 2019, the European Council decided to extend the period referred to in Article 50(3) of the Treaty of the European Union.

As of the withdrawal date, counterparties established in the United Kingdom will no longer be able to perform certain so-called "life-cycle events" (such as novations, unwinding by entering into an offsetting transaction, compression with new replacement contracts, etc.) in the EU under the current passport regime². The performance of those "life-cycle events" on certain cross-border (UK-EU27) contracts may require authorisation in Member States, in line with national third country regimes that still prevail today under Regulation (EU) No 600/2014. These counterparties established in the United Kingdom could then face up to 27 different national third-country regimes.

In order to address this situation, counterparties to these transactions might choose to novate their contracts to entities established and authorised in the EU27. However, the new contracts resulting from these novations might be subject to margin requirements that were not applicable at the time the original contracts were entered into and for which, in the absence of the UK's withdrawal from the EU, they might have continued benefiting from the exemption. The triggering of those requirements may force certain counterparties to discontinue those transactions, leaving certain risks unhedged.

On 19 December 2018, the Commission proposed amendments to address this disincentive to transfer contracts to firms established in the EU27 by extending the current exemptions envisaged in the existing Delegated Regulation for a fixed period of time thus ensuring the smooth functioning of the market and a level playing field between counterparties established in the Union.

One of the conditions for application of the amendments was that a decision had not been taken to extend the two year period referred to in Article 50(3) of the Treaty on European Union. The amendments adopted on 19 December 2018 will therefore not apply following the decision of the European Council of 21 March 2019. Nevertheless, the reasons underlying those amendments remain, in particular the possibility that certain risks remain unhedged should the exemptions not be extended in case of a withdrawal without an agreement.

The Commission therefore proposes amendments to address this new development by amending Delegated Regulation (EU) 2016/2251 accordingly.

2. CONSULTATIONS PRIOR TO THE ADOPTION OF THE ACT

Given the urgency with which it is necessary to provide this regulatory solution in order to facilitate the transfer of contracts to counterparties located in the EU in view of the withdrawal of the United Kingdom without an agreement, where counterparties decide to do

¹ https://ec.europa.eu/commission/sites/beta-political/files/draft_withdrawal_agreement_0.pdf.

² Freedom to provide investment services and activities under Article 34 of Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU

so, in accordance with Article 10(1) of the ESMA Regulation, 10(1) of the EBA Regulation and 10(1) of the EIOPA Regulation, the European Supervisory Authorities ('the ESAs') have not conducted any open public consultation.

Together with the draft technical standards, the ESAs submitted a report detailing the rationale used in the development of the final draft regulatory technical standards submitted to the Commission.

3. LEGAL ELEMENTS OF THE DELEGATED ACT

The delegated act introduces a modification to the existing RTS on the margin requirements:

Article 1 modifies Article 35 of Delegated Regulation (EU) 2016/2251, allowing contracts with a counterparty established in the United Kingdom currently subject to risk-management procedures established prior to the relevant dates of application of that Regulation to be novated for a fixed period of 12 months as long as the sole purpose of the novation is to replace the counterparty established in the United Kingdom with a counterparty established in a Member State.

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

of 28.3.2019

amending Delegated Regulation (EU) 2016/2251 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council as regards the date until which counterparties may continue to apply their risk-management procedures for certain OTC derivative contracts not cleared by a CCP

(Text with EEA relevance)

THE EUROPEAN COMMISSION,

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

Having regard to Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories³, and in particular Article 11(15) thereof,

Whereas:

- (1) On 29 March 2017, the United Kingdom submitted the notification of its intention to withdraw from the Union pursuant to Article 50 of the Treaty on European Union. The Treaties will cease to apply to the United Kingdom from the date of entry into force of a withdrawal agreement, or failing that, two years after that notification, unless the European Council, in agreement with the United Kingdom, unanimously decides to extend that period.
- (2) Commission Delegated Regulation (EU) 2019/397⁴ provides for an amendment to Commission Delegated Regulation (EU) 2016/2251⁵ as regards the date until which counterparties may continue to apply their risk-management procedures for certain OTC derivative contracts not cleared by a CCP. Pursuant to Article 2 of Delegated Regulation (EU) 2019/397, that Regulation is to apply from the date following that on which the Treaties cease to apply to and in the United Kingdom pursuant to Article 50(3) of the Treaty on European Union, unless a withdrawal has entered into force by that date or the two year period referred to in Article 50(3) of the Treaty on European Union has been extended.
- (3) By letter of 20 March 2019, the United Kingdom submitted a request for an extension of the period provided for in Article 50(3) of the Treaty on European Union until 30

³ OJ L 201, 27.7.2012, p. 1.

⁴ Commission Delegated Regulation (EU) 2019/397 of 19 December 2018 amending Delegated Regulation (EU) 2016/2251 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council as regards the date until which counterparties may continue to apply their risk-management procedures for certain OTC derivative contracts not cleared by a CCP (OJ L 71, 13.3.2019, p. 15).

⁵ Commission Delegated Regulation (EU) 2016/2251 of 4 October 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 (OJ L 340, 15.12.2016, p. 9).

June 2019, with a view to finalising the ratification of the Withdrawal Agreement⁶. On 21 March 2019, the European Council agreed to an extension until 22 May 2019, provided the Withdrawal Agreement is approved by the House of Commons in the following week. If that is not the case, the European Council agreed to an extension until 12 April 2019. Consequently, Delegated Regulation (EU) 2019/397 will not apply.

- (4) However, the reasons underlying Delegated Regulation (EU) 2019/397 will remain, regardless of any extension of the period referred to in Article 50(3) of the Treaty on European Union. In particular, the risks to the smooth functioning of the market and a level playing field between counterparties established in the Union will persist in the case of the United Kingdom's withdrawal from the Union without an agreement after the extended period. Those risks are expected to remain for the foreseeable future.
- (5) Delegated Regulation (EU) 2016/2251 should therefore be amended accordingly.
- (6) This Regulation is based on the draft regulatory technical standards submitted by the European Banking Authority, the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority to the Commission.
- (7) It is necessary to facilitate the implementation of efficient solutions by market participants as quickly as possible. Therefore, the European Banking Authority, the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority have analysed the potential related costs and benefits but have not conducted any open public consultation in accordance with the second subparagraph of Article 10(1) of Regulation (EU) No 1093/2010 of the European Parliament and of the Council⁷, the second subparagraph of Article 10(1) of Regulation (EU) No 1094/2010 of the European Parliament and of the Council⁸ and the second subparagraph of Article 10(1) of Regulation (EU) No 1095/2010 of the European Parliament and of the Council⁹. For the same reason, this Regulation should enter into force on the day following that of its publication,

HAS ADOPTED THIS REGULATION:

Article 1

Article 35 of Delegated Regulation (EU) 2016/2251 is replaced by the following:

Article 35

⁶ Agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community (OJ C 661, 19.2.2019, p. 1).

⁷ 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).

⁸ 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).

⁹ 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).

Transitional provisions

1. 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 or novated between 16 August 2012 and the relevant dates of application of this Regulation.
2. Counterparties referred to in Article 11(3) of Regulation (EU) No 648/2012 may also continue to apply the risk-management procedures that they have in place at 14 March 2019 in respect of non-centrally cleared OTC derivative contracts fulfilling all of the following conditions:
 - (a) the non-centrally cleared OTC derivative contracts have been entered into or novated before either the relevant dates of application of this Regulation as set out in Articles 36, 37 and 38 of this Regulation or [*OP, please insert the date of entry into force of this amending Regulation.*], whichever is earlier;
 - (b) the non-centrally cleared OTC derivative contracts are novated for the sole purpose of replacing a counterparty established in the United Kingdom with a counterparty established in a Member State;
 - (c) the non-centrally cleared OTC derivative contracts are novated between the date following that on which Union law ceases to apply to and in the United Kingdom pursuant to Article 50(3) of the Treaty on European Union and either of the following, whichever is later:
 - (i) the relevant dates of application set out in Articles 36, 37 and 38 of this Regulation; or
 - (ii) 12 months from the date following that on which Union law ceases to apply to and in the United Kingdom pursuant to Article 50(3) of the Treaty on European Union.’

Article 2

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

It shall apply from the date following that on which the Treaties cease to apply to and in the United Kingdom pursuant to Article 50(3) of the Treaty on European Union.

However, this Regulation shall not apply in either of the following cases:

- (a) a withdrawal agreement concluded with the United Kingdom in accordance with Article 50(2) of the Treaty on European Union has entered into force by the date referred to in the second paragraph of this Article;
- (b) a decision has been taken to extend the two year period referred to in Article 50(3) of the Treaty on European Union beyond 31 December 2019.

This Regulation shall be binding in its entirety and directly applicable in all Member States.
Done at Brussels, 28.3.2019

For the Commission
The President
Jean-Claude JUNCKER