

RULE NO. 11/2016

**on the methodology used to determine the value of the derivatives where an insurer is subject to
the resolution process**

In accordance with the provisions of Art. 1(2), Art. 2(1) Letters a), b) and d), Art. 3(1) Letter b), Art. 6(2) and Art. 14 of Government Emergency Ordinance No. 93/2012 on the establishment, organisation and operation of the Financial Supervisory Authority, approved as amended and supplemented by Law No. 113/2013, as subsequently amended and supplemented,

on the basis of the provisions of Art. 160 Letter i) of Law No. 246/2015 on the insurers' recovery and resolution,

further to the deliberations held in the meeting of the Financial Supervisory Authority's Board of 27 January 2016,

the **Financial Supervisory Authority** hereby issues this rule:

CHAPTER I

Object, scope and definitions

Art. 1. – (1) This rule lays down the methodology used to determine the value of derivatives where an insurer is subject to a resolution process.

(2) This rule shall apply to:

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

Art. 2. - (1) The terms and expressions used in this rule shall have the meanings provided for in:

- a) Art. 2 of Law No. 246/2015 on the insurers' recovery and resolution;
- b) Art. 2 of Capital Market Law No. 297/2004, as subsequently amended and supplemented, and in the regulations issued for its application;
- c) Art. 1(2) of Law No. 237/2015 on the authorisation and supervision of the insurance and reinsurance business.

(2) In addition, the terms below shall have the following meanings:

- 1. *financial auditor* – means the financial auditor set out in Art. 55 of Law No. 246/2015;

2. *competent authority* – means the authority set out in Article 2 Point 13 of Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories;

3. *financial derivatives contract* – means the financial derivative instrument set out in Art. 2(1) Point 12 of Law No. 297/2004, as subsequently amended and supplemented;

4. *relevant counterparty* – means the entity which is a party to a financial derivatives contract concluded with an insurer under resolution, including a central counterparty set out in Article 2 Point 1 of Regulation (EU) No 648/2012 ;

5. *reasonable substitution* – means the substitution transaction carried out under conditions consistent with the current market practices and for which best endeavours are used to obtain the most favourable commercial conditions when carried out.

6. *early termination* – means the cessation of the validity of a financial derivatives contract prior to its maturity date or expiry date;

7. *netting set* – means a group of transactions between an institution and one counterparty which forms the object of a legally binding bilateral netting agreement;

8. *substitution transaction* – means the transaction with a financial derivative instrument that originates economic conditions and exposures equivalent to a financial derivatives contract in connection with which early termination has been decided.

CHAPTER II

Early termination of financial derivatives contracts

SECTION 1

General

Art.3 - (1) The Financial Supervisory Authority, hereinafter referred to as *FSA*, as resolution authority, shall exercise its write-down or conversion powers in relation to a debt of the insurer under resolution originating in a financial derivative instrument only when it is due or after the early termination of the financial derivatives contracts.

(2) After the resolution procedure is started, FSA, as resolution authority, may early terminate any financial derivatives contract concluded by an insurer under resolution.

Art.4 - (1) Before exercising its power to write down or convert debts into capital instruments, FSA, as resolution authority, shall notify its decision with regard to the early

termination of the financial derivatives contracts to all counterparties mentioned in the financial derivatives contracts of the insurer under resolution.

(2) The decision of early termination of the financial derivatives contracts may be applied immediately or on a date following the transmission of the notification referred to in Para (1).

(3) In the decision referred to in Para (1), FSA, as resolution authority, shall indicate the date and time of fulfilment of the conditions set out in Art. 7(1), whereby the counterparties in the financial derivatives contracts provide evidence of the commercial transactions in connection with which the reasonable substitution of the financial derivatives contracts subject to early termination is made.

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

SECTION 2

Comparative assessment

Art. 5 - (1) The financial auditor must make the following comparisons:

a) the value of the losses which would be generated by the financial derivatives contracts, obtained by the multiplication of:

(i) the share of the obligations arising out of the financial derivatives contracts, of all obligations of the same rank;

(ii) the total losses expected to be incurred by all liabilities of equal rank of the financial derivatives contracts, including the debts resulting from the early termination of the financial derivatives contracts;

by

b) the value of impairments/losses calculated based on the assessment of costs, expenses or other impairments/losses which are expected to be incurred as a result of the early termination of the financial derivatives contracts, obtained by summing up:

(i) the risk of increase in the termination receivables of the counterparty, receivables from the costs with position re-hedging transactions expected to be incurred by the contractual partner, by taking into account the difference between the prices of the best purchase offer and sale offer in accordance with Art. 7(2) Letter b);

(ii) the costs expected to be incurred by the insurer under resolution for the identification of any transaction with financial derivatives contracts deemed necessary, in order to restore the situation

of the position hedging for any open position, or to maintain an acceptable risk profile in accordance with the resolution strategy. This can be achieved by taking into account the initial margin requirements and the difference between the prices of the best purchase offer and sale offer for the financial derivatives contracts;

(iii) any reduction in the value of the rights resulting from the early termination of the financial derivatives contracts, including any impairment/loss of value resulting from assessments of the underlying assets or other assets, which are related to the financial derivatives contracts, which are terminated and any impact on the financing costs or on the level of income;

(iv) any other additional amounts against possible negative effects resulting from the early termination, such as errors or litigation concerning the transactions or the release of the securities lodged.

(2) The comparisons referred to in Para (1) shall be made before making any decision of early termination, as part of the assessment for the substantiation of the decisions on the resolution measures.

CHAPTER III

Value of early termination

SECTION 1

General

Art. 6 The financial auditor shall determine the value of the obligations arising from the financial derivatives contracts of the netting set as a value of early termination calculated as the sum between:

- a) the amounts not paid, collateral or other amounts owed by the insurer under resolution to the relevant counterparty, less the amounts not paid, collateral and other amounts owed by that relevant counterparty to the insurer under the resolution on the date of termination of the financial derivatives contracts;

and

- b) the amounts which shall cover the value of the losses or expenses incurred by the relevant counterparty, or the gains realised by it on the substitution of the financial derivatives contracts or on obtaining equivalent economic advantages due to the materialisation of the clauses of the financial derivatives contracts and rights corresponding to the option of the parties in connection with the termination of the contracts.

Art. 7 - (1) Where the relevant counterparty provided relevant information, within the time limit set out in Art. 4(3), on commercial transactions to which the reasonable substitution of the financial derivatives contracts subject to early termination is made, the financial auditor, based on the information received by FSA from the relevant counterparties and sent to it, shall determine the value of early termination at the price of those substitution transactions.

(2) Where the relevant counterparty did not provide any documents, certificates or evidence on the substitution transactions within the time limit set out in Art. 4(3), or where the financial auditor concludes that these transactions were not carried out on commercially reasonable terms, the financial auditor shall determine the value of early termination based on:

a) the average price between the best sale offer and the best purchase offer existing on the market of that financial derivatives contract at the end of the day, in accordance with Art. 10;

b) the difference between the average price referred to in Letter a) and the price of the best sale offer or of the best purchase offer, depending on the direction of the open position netted off to estimate the loss or the cost expected to be incurred by the relevant counterparty as a result of the early termination, taking into account the achievement or restoration of any position hedging transaction relating to the financial derivatives contract;

c) the adjustments to the assessment referred to in Letter b), so as to reflect the extent of exposure and credit risk of the counterparty.

(3) With relation to the intra-group debts, the financial auditor may determine the value in accordance with Para (2) Letter a), notwithstanding the provisions of Para 2 Letters b) and c), where the resolution strategy would involve position re-hedging transactions of the early terminated financial derivatives contracts with other intra-group transactions.

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

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

b) the data available at the level of the insurer under resolution, such as internal models and assessments, including independent price verifications made in accordance with the provisions concerning the assessment of derivatives of Law No. 237/2015;

c) the data provided by the relevant counterparty by means other than evidence of transactions communicated in accordance with Art. 4(3), including data on the assessments used in current or previous litigation regarding similar or related transactions;

- d) the data provided by third parties, such as the market data and quotations of market makers or the values obtained from central counterparties, where a financial derivatives contract is netted off by it;
- e) any other relevant data.

(5) Within the meaning of Para (2) Letter b), FSA, as resolution authority, may request the insurer under resolution to conduct independent price verification by updating the information on the reference date set in accordance with Art. 10, by using the information available at the end of the day of the early termination.

SECTION 2

Derivatives contracts of a netting set

Art. 8 – For the transactions which form the object of a bilateral netting agreement, the financial auditor, based on the information received by FSA from the relevant counterparties and sent to it, shall establish, for all of the contracts of a netting set, a unique value which the insurer under resolution has the legal right to receive or the legal obligation to pay, as a result of the early termination of the financial derivatives contracts of the netting set.

Art. 9 - (1) The financial auditor must determine the value of the obligations arising from the derivatives contracts of a netting set between an insurer under resolution and a central counterparty, based on the assessment principle set out in Art. 6.

(2) The central counterparty shall determine the value of early termination, in accordance with its own procedures applied in the cases of default, and shall send it to FSA, as resolution authority, together with the documents referred to in Para (5).

(3) FSA, as resolution authority, shall inform such central counterparty and the competent authority of its decision to early terminate the financial derivatives contracts. The decision of early termination shall be applied immediately or on a date and time following the date which is mentioned in the notification.

(4) FSA shall, as resolution authority, request the central counterparty to communicate the value of early termination for all of the financial derivatives contracts of the relevant netting set, in accordance with the stages of the procedure applied by that central counterparty in the cases of default.

(5) The central counterparty shall provide FSA, as resolution authority, with the documents corresponding to the procedure applied by that central counterparty in the cases of default, report

the default management measures taken for the termination of the financial derivatives contracts or for the full position re-hedging of the insurer under resolution, which is in default.

(6) FSA shall, as resolution authority, based on an agreement concluded with the central counterparty and its competent authority, indicate the deadline by which the central counterparty must provide the assessment of the value of early termination. For that purpose, FSA, the central counterparty and the competent authority of the central counterparty shall take into account:

a) the procedure applied by that central counterparty in the cases of default, as established by the governance arrangements of the central counterparty in accordance with Regulation (EU) No 648/2012;

b) the timetable of resolution measures, established by FSA, as resolution authority.

(7) The central counterparty shall confirm to FSA, as resolution authority, that it can communicate the termination value within the agreed deadline.

(8) By way of exception from the provisions of Para (1), FSA, as resolution authority, taking into account the circumstances of the specific situation and, in exceptional circumstances, may decide to apply the provisions of Art. 7(2), after consulting the competent authority of the central counterparty, in any of the following situations:

a) the central counterparty does not communicate the assessment of the value of early termination within the deadline indicated by FSA, as resolution authority, in accordance with Para (6);

b) FSA, as resolution authority, has proof that the central counterparty failed to communicate the assessment of the value of early termination, in accordance with the procedures pre-established by that central counterparty.

(9) All information and documents received by FSA based on the provisions of this article shall be made available to the financial auditor for the fulfilment of the latter's obligations.

SECTION 3

Time of assessment

Art. 10 The financial auditor must determine the value of the obligations resulting from the financial derivatives contracts as follows:

a) on the date and time of the substitution transactions, where the financial auditor determines the value of the early termination at the prices of the substitution transactions in accordance with Art. 7(1);

- b) on the date and time when the value of the early termination was determined by the central counterparty, where the financial auditor determines the value of the early termination, in accordance with the procedures pre-established by the central counterparty as provided for in Art. 9(2);
- c) on the date of the early termination or, where such date is impossible in commercial terms, on the date and time when a market price is available for the underlying asset of the financial derivatives contract, in all other cases.

CHAPTER IV

Final provisions

Art.11 - This rule shall be published in the Official Journal of Romania, Part I, and shall enter into force on the date of its publication.

President of the Financial Supervisory Authority,
Mișu Negrițoiu

Bucharest, 28.01.2016

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