6 June 2017

General Manager, Policy Development
Policy and Advice Division
Australian Prudential Regulation Authority

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Dear Ms Richards

CPS 226 Update – Cross-border application of rules

The Australian Financial Markets Association (AFMA) welcomes the opportunity to comment on consultation draft of Prudential Standard CPS 226 Margining and risk mitigation for non-centrally cleared derivatives (CPS 226 SC Update).

At a general level AFMA supports the CPS 226 SC Update and the list of foreign bodies in Attachment D. Our central objective in these comments is to seek clarification on several points to assist entities in applying the rules.

1. Transaction scope of paragraphs 62 to 64

Substituted compliance (SC) should cover a transaction that is under the overlapping scope of CPS 226 and the equivalent rules of a foreign jurisdiction, so that an APRA covered entity may use the counterparty's status under the margin requirements of the relevant foreign jurisdiction to determine whether it is a covered counterparty when applying the foreign margining regime.

The language around the term "transaction" between paragraphs 63 and 64 has given to rise to ambiguity in interpretation. In paragraph 63 it is said that the margin requirements do not apply "*to transactions*" when an APRA covered entity complies with the relevant foreign margin requirements. Paragraph 64 then goes on to say that SC is only available "*in a transaction*" where an APRA covered entity is transacting with a covered counterparty subject to foreign requirements "and / or" the APRA covered entity is directly subject to the foreign requirements. This leaves open the possibility that SC may only be available when the foreign requirement actually impose an obligation to exchange variation margin in respect of a particular transaction.

We seek a clarification that makes clear that where overlapping rules may apply then SC be available where the APRA covered entity is directly subject (or which its counterparty

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is subject) to the foreign requirements even if the foreign requirements are actually not applied to a specific transaction.

We would also like to seek clarification on the inclusion of "and/or" in paragraph 64 and whether this means only either of these conditions or both of these conditions need to be met for an APRA covered entity to substitute compliance with the margin requirements of a foreign jurisdiction.

2. Counterparty scope of paragraphs 62 to 64

It is AFMA's understanding from previous engagement with APRA that SC covers an entity that is in scope under the APRA regime where the foreign regime applicable to that entity (or which would be applicable to that entity if margin exchange were required) does not require the exchange of margin with that entity. For example, where an APRA covered entity faces an EU EMIR defined above the threshold non-financial counterparty, the parties should be able to elect for SC to apply, and for the parties to elect to comply with the EU rules notwithstanding that this would result in no exchange of margin between the parties. As is the case with the comments in section 1 the interpretation we are applying allows a covered entity to elect, on a counterparty by counterparty basis, whether it wishes to apply SC and if SC is elected, what rule set applies.

AFMA is seeking confirmation that paragraphs 62 to 64 permit the above interpretation.

3. Risk mitigation assessment

Paragraphs 62 to 64 are limited to margining. Given that paragraphs 65 and 66 apply in respect of the risk mitigation requirements of CPS 226, we would appreciate APRA's clarification that the substituted compliance afforded under paragraphs 62 to 64 will also cover the risk mitigation requirements. Alternatively, as you are aware from previous engagements, our members are also greatly interested to receive guidance from APRA on the implementation of the risk mitigation principles set out in CPS226, including the extent to which reliance can be placed on existing ISDA protocols already in place for equivalent requirements under the US Dodd Frank Act and EMIR.

4. Reference to Attachment D for risk mitigation assessments

The Attachment D listings create an obvious reference source for the purpose of making risk mitigation internals assessments on comparability for the purposes of paragraph 65 deference recognition.

Accordingly, we seek confirmation that where a foreign ADI, Category C insurer or EFLIC, the subject of paragraph 65, carries out an internal assessment of the items referred to in points (i – iii) it can place primary reliance on the Attachment D listed foreign bodies if applicable not only for the purposes of margin requirements but also risk mitigation requirements.

We further seek confirmation that the condition outlined in section 2 of Attachment D, does not apply to a foreign ADI, Category C insurer or EFLIC, given paragraph 65 states that these entities that are directly subject to the margin requirements and risk mitigation requirements that are substantially similar to the BCBS-IOSCO framework, may comply in their entirety with the home jurisdiction's requirements.

Please contact David Love either on or by email if further clarification or elaboration is desired.

Yours sincerely

David Love
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