



4 June 2013

To all authorised deposit-taking institutions

Membership of central counterparties

Following the global financial crisis, the G-20 has encouraged regulatory authorities to develop and implement measures to encourage the use of central counterparties (clearing houses and exchanges) for the conduct and settlement of over-the-counter derivatives transactions. To this end, the Basel Committee on Banking Supervision has developed a prudential framework that creates incentives for banks to increase their use of central counterparties. This has led authorised deposit-taking institutions (ADIs) in Australia to consider expanding their participation as members of central counterparties in their own right; to date, ADIs have typically used brokers or subsidiaries to participate.

Against this background, APRA considers it appropriate to outline its policies regarding membership of a central counterparty by a locally incorporated ADI, or other members of a group to which that ADI belongs, or by a foreign ADI.

APRA has no *in principle* objection to a locally incorporated ADI (or a member of a group to which that ADI belongs) or a foreign ADI becoming a member of a central counterparty. In respect of locally incorporated ADIs, this general statement is subject to the following conditions:

- Membership must not expose the ADI (or a group member) to an unlimited contingent liability to support the central counterparty.
- The ADI (or group member) must have an appropriate risk management framework to cover its activities as a member. Such a framework should include, as a minimum:
 - (a) assessment of the risk (financial, operational and reputational) that might arise from membership of and conduct of business through a central counterparty and from any similar engagement with multiple central counterparties;
 - (b) application of appropriate systems and controls to monitor, on a continuing basis, the risk that membership of and conduct of business through a central counterparty or multiple central counterparties may create and to manage such risk. This would include application of limits on potential risk exposures; and
 - (c) maintenance of appropriate capital cover against the risks that may arise from membership of and the conduct of business through a central counterparty and

multiple central counterparties. This would include capital cover relating to business conducted through the central counterparty and any funded support provided to a central counterparty or any contingent support to which the ADI (or group member) may be committed to provide to a central counterparty.

- APRA must be satisfied that it would have access to information, in a timely manner, concerning any operational or financial issues arising from membership of or conduct of business through a central counterparty that may have the potential to adversely impact on the ADI's (or group's) operations, financial position or reputation. This would include any pertinent rulings, advice or actions by those entities responsible for the oversight or regulation of the conduct of business undertaken through the central counterparty or of membership of the central counterparty.
- Where an ADI (or a group member) is a member of a central counterparty, and there is a proposal to change the contractual provisions or rules governing its membership and business undertaken through the central counterparty, APRA must be notified of such prospective rule changes where they may have the potential to impact on the level of exposure incurred from conducting business through the central counterparty or from any support that has to be provided (funded or unfunded) to the central counterparty.
- The ADI must notify APRA of all existing and, on an ongoing basis, intended memberships of central counterparties. Such notifications may be sent to your responsible supervisor. The initial notifications must be made by cob 1 July 2013. APRA will need to be satisfied that membership of a central counterparty meets the conditions outlined above.

For the time being, where a locally incorporated ADI or a member of the ADI's Level 2 group is a member of a central counterparty (whether assessed as a 'qualifying central counterparty' or not), APRA requires that in calculating its capital due to membership of the central counterparty, any contingent liability associated with default exposures is to be treated as if it were a pre-funded contribution to a default fund under paragraph 28 of Attachment C to *Prudential Standard APS 112 Capital Adequacy: Standardised Approach to Credit Risk* (APS 112), and risk-weighted assets calculated accordingly. APRA notes that this capital treatment is an interim measure until the Basel Committee on Banking Supervision releases further guidance on exposures to central counterparties.

APRA considers that membership by a foreign ADI of a central counterparty in Australia is, in the first instance, a matter for the ADI's home supervisor. However, APRA has an interest in such membership as part of its prudential supervision of foreign ADIs in Australia. To this end, APRA requires that:

- The foreign ADI must confirm that its home supervisor has no objections to its membership of a central counterparty in Australia.
- The foreign ADI must have appropriate systems and controls to monitor, on a continuing basis, the risk that membership of and conduct of business through a central counterparty or multiple central counterparties in Australia may create and to manage such risk.
- APRA must be satisfied that it would have access to information, in a timely manner, concerning any operational or financial issues arising from the foreign ADI's

membership of or conduct of business through a central counterparty that may have the potential to adversely impact on the foreign ADI's operations, financial position or reputation. This would include any pertinent rulings, advice or actions by those entities responsible for the oversight or regulation of the conduct of business undertaken through the central counterparty or of membership of the central counterparty.

- Where a foreign ADI is a member of a central counterparty, and there is a proposal to change the contractual provisions or rules governing its membership and business undertaken through the central counterparty, APRA must be notified of such prospective rule changes where they may have the potential to impact on the level of exposure which the foreign ADI may incur in conducting business through the central counterparty or from any support that has to be provided (funded or unfunded) to the central counterparty.
- The foreign ADI must notify APRA of all existing and, on an ongoing basis, intended memberships of central counterparties in Australia. Such notifications may be sent to your responsible supervisor. The initial notifications must be made by cob 1 July 2013. APRA will need to be satisfied that membership of a central counterparty in Australia meets the conditions outlined above.

Please contact me or Jane O'Doherty on 9210 3175 if you any further queries.

Yours sincerely



Charles Littrell
Executive General Manager
Policy, Research and Statistics