



14 August 2019

TO: ALL APRA-REGULATED INSTITUTIONS OTHER THAN PRIVATE HEALTH INSURERS

CONSULTATION ON AMENDMENTS TO MARGIN REQUIREMENTS

Prudential Standard CPS 226 Margining and risk mitigation for non-centrally cleared derivatives (CPS 226) came into effect from 1 March 2017. CPS 226 applies to all authorised deposit-taking institutions, general insurers, life companies and registrable superannuation entities. It is relevant to those entities who transact in material levels of non-centrally cleared derivatives.

In July 2019, the Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO) released amendments to the margin requirements.¹ APRA is now commencing consultation on revisions to CPS 226 to extend the implementation timeline for margin requirements, as well as making other minor amendments.

Implementation timeline for initial margin requirements

The BCBS and IOSCO have approved a one-year extension to the final implementation of margin requirements from 1 September 2020 to 1 September 2021. In doing so, the BCBS and IOSCO have also adjusted the phase-in schedule requiring covered entities with an aggregate average notional amount (AANA) of non-centrally cleared derivatives greater than EUR 50 billion to be subject to margin requirements from 1 September 2020.

APRA supports this extension and proposes to delay the final implementation phase by one year from 1 September 2020 to 1 September 2021. APRA also proposes to increase the qualifying level of AANA of non-centrally cleared derivatives applicable from 1 September 2020 from AUD 12 billion to AUD 75 billion, and defer the application of margin requirements to APRA covered entities with an AANA of non-centrally cleared derivatives greater than AUD 12 billion to 1 September 2021.² This amount has been determined using the exchange rate used to convert EUR amounts in CPS 226.

Substituted compliance and other matters

An APRA covered entity may substitute compliance with the margin requirements or provisions (in their entirety) of any of the foreign bodies listed in Attachment D to CPS 226 for compliance with the margin requirements in CPS 226. An APRA covered entity may only substitute compliance in a transaction where the APRA covered entity is directly subject to the relevant foreign requirements or provisions, or where it is transacting with a covered counterparty that is subject to the relevant foreign margin requirements or provisions.

¹ Basel Committee on Banking Supervision and International Organization of Securities Commissions, *Margin Requirements for non-centrally cleared derivatives* (Standard, July 2019), <https://www.bis.org/bcbs/publ/d475.htm>

² An APRA covered entity is defined in paragraph 3 of CPS 226.

APRA has previously confirmed that the margin requirements of the European Commission are equivalent to APRA's margin requirements and substituted compliance is permitted under CPS 226. To ensure a smooth transition and greater certainty in the event of Brexit, APRA will amend the list of foreign bodies whose margin requirements are approved for substituted compliance with the margin requirements in CPS 226 to include the UK's Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) who are jointly responsible for margin requirements in the UK, provided that the PRA and FCA's margin requirements are substantively unchanged following the UK's withdrawal from the European Union. In this event, APRA intends to make this amendment to paragraph 1 of Attachment D to CPS 226 expeditiously following Brexit or once the UK's rules are in place.

In response to issues raised by industry globally, the BCBS and IOSCO issued a joint statement in March 2019, which clarified that the documentation, custodial and operational requirements for initial margin do not apply in cases where the initial margin is less than EUR 50 million. This threshold represents the point below which an entity is not required to post and collect initial margin. Following the BCBS and IOSCO's clarification, APRA proposes to clarify that an APRA covered entity is not required to have initial margin documentation, custodial arrangements and operational processes in place for posting and collecting initial margin in cases where the bilateral initial margin amount for a particular trading relationship is less than the AUD 75 million initial margin threshold. However, APRA would expect APRA covered entities to act diligently to monitor their exposures and ensure they have initial margin documentation, custodial arrangements and operational processes in place for posting and collecting initial margin as their exposures approach the threshold.

APRA also proposes to amend footnote 7 which provides the meaning of 'new' non-centrally cleared derivatives transactions. For clarity, APRA proposes to add that amending contracts for existing derivative transactions solely for the purpose of addressing interest rate benchmark reforms, such as the LIBOR reforms, would not qualify as new derivative transactions and are, therefore, not subject to margin requirements. This amendment is consistent with the BCBS and IOSCO public statement in March 2019.

APRA will also be updating the date of the BCBS-IOSCO framework in paragraph 9(c) of CPS 226 and removing paragraph 73 which is out of date.

APRA invites feedback on the draft revisions to CPS 226 set out in Attachment A to this letter, which will be subject to a two-week public consultation. APRA intends to release a final revised version of CPS 226 as soon as practicable after the consultation period.

Written submissions on the proposal should be sent to PolicyDevelopment@apra.gov.au by 28 August 2019 and addressed to:

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

Yours sincerely,

John Lonsdale
Deputy Chair

Important disclosure notice – publication of submissions

All information in submissions will be made available to the public on the APRA website unless a respondent expressly requests that all or part of the submission is to remain in confidence. Automatically generated confidentiality statements in emails do not suffice for this purpose. Respondents who would like part of their submission to remain in confidence should provide this information marked as confidential in a separate attachment.

Submissions may be the subject of a request for access made under the *Freedom of Information Act 1982* (FOIA). APRA will determine such requests, if any, in accordance with the provisions of the FOIA. Information in the submission about any APRA-regulated entity that is not in the public domain and that is identified as confidential will be protected by section 56 of the *Australian Prudential Regulation Authority Act 1998* and will therefore be exempt from production under the FOIA.

ATTACHMENT A – DRAFT AMENDMENTS TO CPS 226 (EXTRACT)

12. Variation margin must be exchanged for all new⁷ non-centrally cleared derivative transactions, with the exception of physically settled foreign exchange (FX) forwards and swaps,^{8,9} entered into during the relevant margining period in the third column of Table 1.¹⁰

Footnote 7: Genuine amendments to existing derivative transactions do not qualify as a new derivative transaction. This includes any amendments made solely for the purpose of addressing interest rate benchmark reforms. Any amendment that extends an existing derivative transaction for the purpose of avoiding margin requirements must be considered a new derivative transaction. The novation of a grandfathered transaction, or a transaction that results from portfolio compression of grandfathered transactions, does not qualify as a new derivative transaction. However, a transaction resulting from compression of both grandfathered transactions and transactions which are subject to mandatory margin requirements is subject to the margin requirements in this Prudential Standard.

18. Initial margin must be posted and collected for all new non-centrally cleared derivative transactions, with the exception of physically settled FX forwards and swaps, entered into during the relevant margining period in the third column of Table 2.

Table 2: Implementation timetable for initial margin requirements

Reference period	Qualifying level	Margining period
March, April and May 2016	AUD 4.5 trillion	1 March 2017 to 31 August 2017
March, April and May 2017	AUD 3.375 trillion	1 September 2017 to 31 August 2018
March, April and May 2018	AUD 2.25 trillion	1 September 2018 to 31 August 2019
March, April and May 2019	AUD 1.125 trillion	1 September 2019 to 31 August 2020
March, April and May 2020	AUD 75 billion	1 September 2020 to 31 August 2021
March, April and May of each subsequent calendar year	AUD 12 billion	1 September of the year referred to in the first column of this row to 31 August of the next calendar year

22. The threshold applicable to the initial margin for each margining group must not be greater than AUD 75 million. <FN> The threshold is applied bilaterally at the aggregate level of the margining group and is based on all non-centrally cleared derivative transactions between the two margining groups. In the event of a dispute, the undisputed amount must be posted and collected by the two counterparties until the dispute is resolved.

<FN> For the avoidance of doubt, an APRA covered entity is not required under this Prudential Standard to have initial margin documentation, custodial arrangements and operational processes in place for posting and collecting initial margin with a margining group if the bilateral initial margin amount is less than AUD 75 million.