



19 September 2019

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

RESPONSE TO SUBMISSIONS – AMENDMENTS TO MARGIN REQUIREMENTS

Last month, APRA released for consultation its proposed revisions to margin requirements in *Prudential Standard CPS 226 Margining and risk mitigation for non-centrally cleared derivatives* (CPS 226). 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.

The consultation proposed, amongst other minor amendments, to extend the implementation timeline for initial margin requirements. APRA received eight submissions in response to its consultation. All respondents supported the proposals with a few respondents requesting clarity or additional guidance. This letter responds to the requests raised in submissions. The final revised version of CPS 226 has been released concurrently with this letter.

Initial margin requirements

APRA is proceeding with its proposal to amend CPS 226 to:

- delay the final implementation phase for initial margin requirements by one year from 1 September 2020 to 1 September 2021 and in doing so, increase the qualifying level of aggregate average notional amount (AANA) of non-centrally cleared derivatives applicable from 1 September 2020 from AUD 12 billion to AUD 75 billion;
- 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 2021.¹ While one respondent considered this level to be too low, APRA considers that it remains appropriate as it is consistent with the global standard for margin requirements; and
- 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.

One respondent suggested that APRA's expectation that APRA covered entities 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 should be included in CPS 226. Another respondent sought guidance on the level of exposures at which entities should begin this process. As the circumstance and complexity of each APRA covered entity is different, APRA does not consider it appropriate to include specific guidance on when an entity should begin its preparation. APRA covered entities are expected to monitor their

¹ An APRA covered entity is defined in paragraph 3 of CPS 226.

exposures and ensure that documentation, custodial arrangements and operational processes are in place sufficiently in advance of exceeding the threshold.

Genuine amendments to existing derivatives transaction

APRA also proposed to specify that amending contracts for existing derivative transactions solely for the purpose of addressing interest rate benchmark reforms, such as the LIBOR reforms, would be a genuine amendment that does not qualify as a new derivative transaction and is, therefore, not subject to the margin requirements. Two respondents asserted that the clarification should be broader than interest rate benchmark reforms. They sought additional clarification on the interpretation of genuine amendment including for auctions, close-outs and replacements and that it incorporates all genuine processes, changes and updates which occur in the process of benchmark transition and over the transaction lifecycle.

APRA's clarification of genuine amendments is not intended to be exhaustive but rather sets out the broad principles for what could be considered a genuine amendment to an existing derivative transaction. It is, therefore, possible that a range of other activities such as trade compressions, novations, auctions, close-outs and replacements solely used to address benchmark reforms or comply with benchmark regulations for existing trades could be considered genuine amendments.

APRA has broadened the scope to any amendments made solely for the purpose of addressing benchmark reforms, rather than just interest rate benchmark reforms. For example, this could be for the purposes of complying with the European Union Benchmarks Regulation. To provide further clarity to market participants, APRA has added that the application of standard trade maintenance processes on a grandfathered transaction does not qualify as a new derivative transaction. This would include entering into protocols to amend trades to reference updated International Swaps and Derivatives Association definitions.

Substituted compliance

APRA confirms that it intends to 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), provided that the PRA and FCA's margin requirements are substantively unchanged following the UK's withdrawal from the European Union. This change will occur expeditiously following Brexit or once the rules are in place. One respondent requested that the US Securities and Exchange Commission (SEC) also be included on the list of foreign bodies. APRA will assess whether the US SEC's margin requirements should be recognised for substituted compliance.

APRA has also updated the date of the BCBS-IOSCO framework in paragraph 9(c) of CPS 226 and removed out of date requirements.

The final revised version of CPS 226 will take effect upon registration of CPS 226 on the Federal Register of Legislation and can be found on APRA's website at <http://apra.gov.au/margining-and-risk-mitigation-non-centrally-cleared-derivatives>.

Yours sincerely,

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