



7 August 2017

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

**RESPONSE TO SUBMISSIONS – SUBSTITUTED COMPLIANCE FOR MARGIN REQUIREMENTS FOR NON-CENTRALLY CLEARED DERIVATIVES**

APRA has today released the final revised *Prudential Standard CPS 226 Margining and risk mitigation for non-centrally cleared derivatives* (CPS 226), which permits substituted compliance with respect to the margin requirements or provisions of the following foreign bodies:

- Canada’s Office of the Superintendent of Financial Institutions;
- the European Commission;
- the Hong Kong Monetary Authority;
- Japan’s Financial Services Agency;
- Japan’s Ministry of Economy, Trade and Industry and Ministry of Agriculture, Forestry and Fisheries;
- the Monetary Authority of Singapore;
- the Swiss Financial Market Supervisory Authority;
- the United States Commodity Futures Trading Commission; and
- the United States Farm Credit Administration, Federal Deposit Insurance Corporation, Federal Housing Finance Agency, Board of Governors of the Federal Reserve System and Office of the Comptroller of the Currency.

In May 2017, APRA released for consultation a draft of CPS 226. APRA proposed amending CPS 226 to allow an APRA-regulated institution to substitute compliance with the margin requirements or provisions of a comparable foreign jurisdiction for the requirements in CPS 226.

APRA received three submissions on its proposals. Respondents were broadly supportive of APRA’s proposals but sought clarity on a number of aspects. APRA’s responses to the key matters raised are set out below.

**Scope of transactions eligible for substituted compliance**

Respondents requested clarification on whether an APRA covered entity can rely on substituted compliance in a transaction where the exchange of margins would be required under CPS 226 but would not be required under foreign requirements.

Substituted compliance is intended to alleviate the burden of complying with multiple sets of rules by enabling counterparties subject to both CPS 226 and equivalent foreign rules to comply with only one set of requirements. APRA has made minor amendments to CPS 226 to clarify that substituted compliance is permitted for a trading relationship where the obligation to exchange margins under both CPS 226 and equivalent foreign margin requirements applies, or would apply if the covered counterparty's level of non-centrally cleared derivatives exceeded a level specified in those margin requirements. If these conditions are satisfied, substituted compliance is permitted for a transaction between the APRA covered entity and that covered counterparty even if the foreign margin requirements do not require margin to be exchanged in respect of that particular transaction. APRA considers that this approach will minimise operational complexity whilst limiting opportunities to evade margin requirements.

Respondents also requested clarification that an APRA covered entity can rely on substituted compliance in determining whether a counterparty is a covered counterparty. APRA confirms that, where substituted compliance is permitted for that trading relationship, an APRA covered entity may use the counterparty's status under the margin requirements of the relevant foreign jurisdiction.

An entity that is domiciled in a foreign jurisdiction but that does not have any obligation to exchange margins under that jurisdiction's requirements (other than because its level of non-centrally cleared derivatives activity is below a level specified in those requirements) is not considered to be subject to those foreign margin requirements. The definition of covered counterparty in CPS 226 must be applied in transactions with such counterparties. CPS 226's definition of financial institution is function based and intended to align with other jurisdictions' definitions in practice. In satisfying the due diligence requirements in paragraph 29 of CPS 226, an APRA covered entity may use a counterparty's self-declaration or public disclosure of its status under foreign rules in combination with its own understanding of that counterparty's business operations.

### **Scope of requirements eligible for substituted compliance**

Respondents requested clarification on the application of substituted compliance with respect to the risk mitigation requirements in CPS 226. APRA does not intend to extend substituted compliance to the risk mitigation requirements in CPS 226. These requirements are principles based and an APRA covered entity should satisfy itself that it has taken the necessary steps to meet these requirements.

One submission also noted that the difference between margin 'requirements' and 'provisions' is unclear and requested APRA specify which elements of CPS 226 are margin requirements. APRA proposed referring to 'foreign margin requirements or provisions' because some of the material issued or administered by the foreign bodies is implemented through prudential supervisory action and not legal requirements. CPS 226 has been amended to specify that all requirements in CPS 226 except for the risk mitigation requirements in paragraphs 71 to 94 are margin requirements.

### **Deference to home jurisdiction requirements by foreign ADIs, Category C insurers and eligible foreign life insurance companies**

Respondents requested clarification regarding the interaction between the deference provision for foreign branches in Australia in paragraph 65 of CPS 226 and the proposed changes to permit substituted compliance.

APRA confirms the deference provision for foreign branches in Australia continues to operate independent of substituted compliance. The condition with respect to intra-group margin requirements set out in paragraph 2(a) of Attachment D of CPS 226 does not apply with respect to deference under paragraph 65. Where a foreign branch in Australia elects to comply

with the margin requirements of its home jurisdiction in lieu of the margin requirements in CPS 226 and its home jurisdiction is listed in Attachment D, the branch may rely on APRA's assessment of its home jurisdiction's margin requirements in undertaking the internal assessment required under paragraph 65. This reliance does not extend to deference to foreign risk mitigation requirements.

APRA has released the final revised CPS 226 along with this letter. The revised CPS 226 will take effect on 1 September 2017. These documents can be found on the APRA website at: <http://www.apra.gov.au/CrossIndustry/Pages/Response-Substituted-compliance-August-2017.aspx>

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'Pat Brennan', with a long horizontal flourish extending to the right.

Pat Brennan  
Executive General Manager  
Policy and Advice Division