

COMMISSION IMPLEMENTING DECISION (EU) 2021/1106**of 5 July 2021****on the recognition of the legal, supervisory and enforcement arrangements of Australia for derivatives transactions supervised by the Australian Prudential Regulation Authority as equivalent to certain requirements of Article 11 of Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories****(Text with EEA relevance)**

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories ⁽¹⁾, and in particular Article 13(2) thereof,

Whereas:

- (1) Article 13 of Regulation (EU) No 648/2012 provides for a mechanism under which the Commission is empowered to adopt equivalence decisions whereby the legal, supervisory and enforcement arrangements of a third country are declared equivalent to the requirements laid down in Articles 4, 9, 10 and 11 of Regulation (EU) No 648/2012 so that counterparties which enter into a transaction within the scope of that Regulation, where at least one of the counterparties is established in that third country, are deemed to have fulfilled those requirements by complying with the requirements set out in that third country's legal regime. The declaration of equivalence contributes to the achievement of the overarching aim of Regulation (EU) No 648/2012 namely to reduce systemic risk and increase the transparency of derivatives markets by ensuring an internationally consistent application of the principles agreed with third countries and laid down in that Regulation.
- (2) Article 11(1), (2) and (3) of Regulation (EU) No 648/2012 which is supplemented by Commission Delegated Regulation (EU) No 149/2013 ⁽²⁾ and Commission Delegated Regulation (EU) 2016/2251 ⁽³⁾, establish the Union's legal requirements concerning the timely confirmation of the terms of an OTC derivative contract, the conduct of a portfolio compression exercise and the arrangements under which portfolios are reconciled in relation to OTC derivative contracts not cleared by a central counterparty ('CCP'). In addition, those provisions lay down the valuation and dispute resolution obligations applicable to those contracts ('operational risk mitigation techniques') as well as the obligations on the exchange of collateral ('margins') between counterparties.
- (3) In order for a third country's legal, supervisory and enforcement regime to be considered equivalent to the regime of the Union in respect of operational risk mitigation techniques and margins requirements, the substantive outcome of the applicable legal, supervisory and enforcement arrangements is to be equivalent to Union requirements under Article 11 of Regulation (EU) No 648/2012, ensure protection of professional secrecy that is equivalent to the protection provided for in Article 83 of that Regulation. Furthermore, equivalent legal, supervisory and enforcement arrangements must be effectively applied in an equitable and non-distortive manner in that third country. The assessment of equivalence therefore encompasses a verification whether the legal, supervisory and enforcement arrangements of a third country ensure that OTC derivative contracts not cleared by a CCP and entered into by at least one counterparty established in that third country do not expose financial markets in the Union to a higher level of risk and consequently do not pose unacceptable levels of systemic risk in the Union.

⁽¹⁾ OJ L 201, 27.7.2012, p. 1.

⁽²⁾ Commission Delegated Regulation (EU) No 149/2013 of 19 December 2012 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on indirect clearing arrangements, the clearing obligation, the public register, access to a trading venue, non-financial counterparties, and risk mitigation techniques for OTC derivatives contracts not cleared by a CCP (OJ L 52, 23.2.2013, p. 11).

⁽³⁾ Commission Delegated Regulation (EU) 2016/2251 of 4 October 2016 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories with regard to regulatory technical standards for risk-mitigation techniques for OTC derivative contracts not cleared by a central counterparty (OJ L 340, 15.12.2016, p. 9).

- (4) On 1 October 2013, the Commission received the technical advice of the European Securities and Markets Authority ('ESMA') on the legal, supervisory and enforcement arrangements in Australia ⁽⁴⁾ including the operational risk mitigation techniques applicable to OTC derivative contracts not cleared by a CCP. In its technical advice, ESMA concluded that there were no legally binding requirements on timely confirmation of the terms of an OTC derivative contract, the arrangements for carrying out portfolio reconciliation, the conduct of a portfolio compression, the valuation of a portfolio and the obligation for dispute resolution or for the exchange of collateral between counterparties to OTC derivative contracts in Australia. ESMA also observed that the equivalence between regimes for bilateral margins could not be assessed at the time, as the technical standards specifying the rules on bilateral margins in the Union had not yet been developed.
- (5) The Commission has considered ESMA's technical advice in carrying out its assessment, and has taken into account the regulatory developments that have taken place since then. The Commission has made a comparative analysis of the legal, supervisory and enforcement requirements applicable in Australia. It also assessed the outcome of those requirements and their adequacy to mitigate the risks arising from OTC derivative contracts not cleared by a CCP in a manner considered equivalent to the outcome of the requirements laid down in Regulation (EU) No 648/2012.
- (6) The legal, supervisory and enforcement arrangements applicable in Australia for transactions on non-centrally cleared derivative contracts are set out in Prudential Standard CPS 226 of the Australian Prudential Regulation Authority ('APRA') adopted under section 11AF of the Banking Act 1959 (Banking Act), section 32 of the Insurance Act 1973 (Insurance Act), section 230A of the Life Insurance Act 1995 (Life Insurance Act) and section 34C of the Superannuation Industry (Supervision) Act 1993 (SIS Act). APRA's mandate is to ensure the safety and soundness of prudentially regulated financial institutions so that they meet their financial commitments to depositors, policyholders and fund members within a stable, efficient and competitive financial system. Prudential Standard CPS 226 requires an entity covered by those rules to have appropriate margining and risk mitigation practices in relation to non-centrally cleared derivatives. That Prudential Standard applies to institutions in the banking, general insurance, life insurance and superannuation industries, subject to certain thresholds. Prudential Standard CPS 226 entered into force on 1 March 2017. Some of its requirements are subject to a phase-in in accordance with the international framework and aligned with the existing phase-in in Delegated Regulation (EU) 2016/2251.
- (7) Prudential Standard CPS 226 applies to non-centrally cleared derivatives, with the exception of foreign-exchange contracts with a maturity of less than three days. The definition of non-centrally cleared derivatives in Prudential Standard CPS 226 is broader than that of OTC derivatives provided for in Article 2 of Regulation (EU) No 648/2012. Paragraph 9(g) of Prudential Standard CPS 226 defines 'derivative' as either a derivative within the meaning of Chapter 7 of the Corporations Act 2001, or an arrangement that is a forward, swap or option, or any combination of those things, in relation to one or more commodities. Equivalence should therefore be recognised with respect to OTC derivatives that are subject to margins under paragraph 9(g) of Prudential Standard CPS 226.
- (8) Prudential Standard CPS 226 generally applies to transactions in non-centrally cleared derivatives conducted between 'APRA covered entities' and 'covered counterparties'. 'APRA covered entities' are authorised deposit-taking institutions (ADIs), including foreign ADIs, and non-operating holding companies authorised under the Banking Act, general insurers, including Category C insurers, non-operating holding companies authorised under the Insurance Act, and parent entities of Level 2 insurance groups, life companies including friendly societies and eligible foreign life insurance companies (EFLICs), and non-operating holding companies registered under the Life Insurance Act and registrable superannuation entity under the SIS Act in respect of their business operations. The definition of 'covered counterparties' broadly corresponds to the definition of 'financial counterparty' in Article 2(8) of Regulation (EU) No 648/2012 while excluding in a similar manner special purpose vehicles where the transaction is conducted for the sole purpose of hedging. The definition of 'covered counterparties' does not take into consideration the jurisdictional location of the counterparty as long as there is no doubt as to the enforceability of the netting agreement upon insolvency or bankruptcy of the counterparty or where collateral arrangements are not questionable and are legally enforceable upon default of the counterparty.

⁽⁴⁾ ESMA/2013/1373, Technical advice on third country regulatory equivalence under EMIR – Australia, European Securities and Markets Authority, 1 October 2013.

- (9) In accordance with paragraph 11 of Prudential Standard CPS 226, obligations to exchange variation margin are only applicable to counterparties to a transaction where the amount of non-centrally cleared derivatives of both counterparties exceeds, on an aggregated and consolidated basis, a *de minimis* threshold of AUD 3 billion. No such threshold exists under Regulation (EU) No 648/2012. Recognition of equivalence should therefore be conditional on the exchange of variation margin between counterparties subject to Article 11 of Regulation (EU) No 648/2012 and APRA covered entities.
- (10) Prudential Standard CPS 226 contains similar obligations to those provided for in Article 11(1) and (2) of Regulation (EU) No 648/2012 and in Chapter VIII of Delegated Regulation (EU) No 149/2013. In particular, paragraphs 77 to 94 of that Prudential Standard contain specific requirements regarding timely confirmation, portfolio compression, portfolio reconciliation, transaction valuation and dispute resolution applicable to OTC derivative contracts not cleared by a CCP. With regard to timely confirmation, the requirements set out in Prudential Standard CPS 226 cannot be considered equivalent as they require transactions to be confirmed only 'as soon as practicable' while Delegated Regulation (EU) No 149/2013 sets a maximum period for the transaction to be confirmed. With regard to portfolio reconciliation, the requirements set out in Prudential Standard CPS 226 cannot be considered equivalent as the frequency at which a portfolio is to be reconciled is not specified in Prudential Standard CPS 226 while it is precisely determined in Delegated Regulation (EU) No 149/2013. With regard to dispute resolution, the requirements set out in Prudential Standard CPS 226 cannot be considered equivalent as, contrary to Delegated Regulation (EU) No 149/2013, that Prudential Standard does not provide for a specific process for disputes that are not resolved within five working days. With regard to portfolio compression and transaction valuation, the requirements set out in Prudential Standard CPS 226 could be considered equivalent in outcome to those set out in Articles 13 and 14 of Commission Delegated Regulation (EU) No 149/2013.
- (11) In relation to non-centrally cleared derivative contracts covered under Prudential Standard CPS 226, the legal, supervisory and enforcement arrangements applicable to APRA covered entities should therefore be considered equivalent to the requirements set out in Article 11(1) and (2) of Regulation (EU) No 648/2012 in respect of portfolio compression and transaction valuation applicable to OTC derivative contracts not cleared by a CCP.
- (12) Pursuant to Prudential Standard CPS 226, variation margin must be exchanged, subject to the *de minimis* threshold referred to in paragraph 11 of that Prudential Standard, and initial margin must be posted and collected for all new non-centrally cleared derivative transactions, with the exception of physically settled foreign exchange forwards and swaps, between an APRA covered entity and a covered counterparty. APRA has adopted the internationally agreed phase-in for the entry into application of the initial margin requirements, the thresholds used for the phase-in expressed in AUD should be considered equivalent to the thresholds referred to in Article 35 of Delegated Regulation (EU) 2016/2251. Similar exemptions for physically settled foreign exchange forwards and swaps and for single-stock equity options or index options are provided for in Delegated Regulation (EU) 2016/2251. This Decision should therefore only apply to OTC derivatives contracts that are subject to margin requirements under Regulation (EU) No 648/2012 and Prudential Standard CPS 226.
- (13) In accordance with Prudential Standard CPS 226, variation margin is to be calculated and called on a daily basis and settlement of variation margin amounts is to be conducted 'promptly'. APRA has publicly stated its expectation that, in practice, settlement of variation margin should occur on a T+1 basis (where T is the date of the margin call). However, such a settlement timeframe might not be feasible in all circumstances due to, for example, time zone and cross-border considerations. Therefore, APRA has adopted a principles-based requirement for the prompt settlement of variation margin to achieve an outcome consistent with other global regulatory requirements for settlement timing for variation margin. Article 12 of Delegated Regulation (EU) 2016/2251 requires all counterparties to an OTC derivative transaction not cleared by a CCP to exchange variation margin on a daily basis or adjust the margin period of risk used to calculate the initial margin accordingly. The arrangements provided for in Prudential Standard CPS 226 with respect to variation margin should be considered equivalent only where those arrangements achieve an outcome equivalent to that achieved by applying the requirements of Regulation (EU) No 648/2012. Therefore, conditions to that effect should be laid down.

- (14) Prudential Standard CPS 226 provides for a combined minimum transfer amount of initial and variation margins of AUD 750 000, whereas Article 25 of Delegated Regulation (EU) 2016/2251 provides for an amount of EUR 500 000. Taking into account the marginal difference between those amounts and the common objective of Prudential Standard CPS 226 and Delegated Regulation (EU) 2016/2251, those amounts should be considered equivalent.
- (15) The requirements in Prudential Standard CPS 226 for the calculation of initial margin should be considered equivalent to the requirements set out in Delegated Regulation (EU) 2016/2251. In a manner similar to the standardised method for the calculation of the initial margin set out in Annex IV to Delegated Regulation (EU) 2016/2251, Prudential Standard CPS 226 allows for the use of a standardised model equivalent to the one laid down in that Annex IV. Alternatively, internal or third party models can be used under Prudential Standard CPS 226 to calculate the initial margin where those models contain certain specific parameters equivalent to those set out in Delegated Regulation (EU) 2016/2251, including minimum confidence intervals and margin periods of risk and certain historical data, including stressed periods. APRA covered entities must apply to APRA for approval to use an internal or third party model and ensure that an independent review of this model is carried out before the approval is sought.
- (16) The requirements in Prudential Standard CPS 226 on eligible collateral and on how that collateral is held and segregated should be considered equivalent to those set out in Article 4 of Delegated Regulation (EU) 2016/2251. Prudential Standard CPS 226 contains an equivalent list of eligible collateral, and an APRA covered entity is to have appropriate controls in place to ensure that the collateral collected does not exhibit significant wrong-way risk or significant concentration risk. Concentration should be assessed in terms of an individual issuer, issuer type and asset type. Margin rules for OTC derivative contracts not cleared by a CCP contained in Prudential Standard CPS 226 should therefore be considered equivalent to those provided for under Article 11(3) of Regulation (EU) No 648/2012.
- (17) With regard to the level of protection of professional secrecy in Australia, information held by APRA, as well as all Commonwealth agencies, is subject to the Privacy Act 1988 ('Privacy Act'). Moreover, the Australian Prudential Regulation Authority Act 1998 ('APRA Act') sets out detailed secrecy provisions that apply to APRA and its employees. In particular, pursuant to section 56(2) of the APRA Act, officers or former officers of APRA are guilty of an offence if they disclose 'protected information' or a 'protected document' to any person or 'to a court' (otherwise than in accordance with the APRA Act). Additionally, Section 70 of the Crimes Act 1914 ('Crimes Act') is a secrecy provision of general application to Commonwealth officers (that is to say public sector employees, including APRA staff and contractors). That provision makes it an offence for Commonwealth officers to disclose any fact or document which comes to their knowledge or into their possession as a result of being a Commonwealth officer, and which they have a duty not to disclose. Taken together, the Privacy Act, the Crimes Act and the APRA Act provide guarantees of professional secrecy, including the protection of business secrets shared by the authorities with third parties, that should be considered equivalent to those set out in Title VIII of Regulation (EU) No 648/2012.
- (18) Finally, with regard to the effective supervision and enforcement of the legal arrangements in Australia, APRA has primary responsibility for the monitoring and enforcement of compliance with Prudential Standard CPS 226. APRA can take a wide range of supervisory measures including undertaking a formal investigation into the affairs of an institution, imposing conditions on an institution's licence or issuing directions related to particular matters, appointing a statutory manager, judicial manager or replacement trustee to manage an institution's affairs, initiating criminal action against persons or institutions or seeking restraining orders. Those measures should therefore be considered to provide for the effective application of the relevant legal, regulatory and enforcement arrangements under Prudential Standard CPS 226 in an equitable and non-distortive manner and to ensure effective supervision and enforcement equivalent to the supervisory and enforcement arrangements available under the Union legal framework.
- (19) This Decision recognises equivalence of binding requirements set out in Australian law relating to OTC derivative contracts applicable at the time of adoption of this Decision. The Commission, in cooperation with ESMA, will monitor on a regular basis the evolution of the legal, supervisory and enforcement arrangements for these OTC derivative contracts and their consistent and effective implementation, regarding the timely confirmation, portfolio compression and reconciliation, valuation, dispute resolution and margin requirements applicable to OTC derivative contracts, not cleared by a CCP with respect to which this Decision has been taken. As part of its

monitoring efforts the Commission may request APRA to provide information on regulatory and supervisory developments. The Commission may undertake a specific review at any time, where relevant developments make it necessary for the Commission to re-assess the declaration of equivalence granted by this Decision. Such re-assessment may lead to the repeal of this Decision, which would as a consequence make counterparties automatically subject again to all requirements laid down in Regulation (EU) No 648/2012.

- (20) The measures provided for in this Decision are in accordance with the opinion of the European Securities Committee,

HAS ADOPTED THIS DECISION:

Article 1

For the purposes of Article 13(3) of Regulation (EU) No 648/2012, the legal, supervisory and enforcement arrangements of Australia for portfolio compression and transaction valuation that are applied to non-centrally cleared derivative transactions regulated by the Australian Prudential Regulation Authority ('APRA') shall be considered equivalent to the requirements set out in Article 11(1) and (2) of Regulation (EU) No 648/2012 where at least one of the counterparties to those transactions is an APRA covered entity as defined under Prudential Standard CPS 226.

Article 2

For the purposes of Article 13(3) of Regulation (EU) No 648/2012, the legal, supervisory and enforcement arrangements of Australia for the exchange of collateral that are applied to non-centrally cleared derivative transactions regulated by APRA shall be considered equivalent to the requirements of Article 11(3) of Regulation (EU) No 648/2012, where the following conditions are satisfied:

- (a) at least one of the counterparties to those transactions is an APRA covered entity as defined under Prudential Standard CPS 226;
- (b) where variation margin is required to be provided under Regulation (EU) No 648/2012, variation margin is provided on the same day on which it is calculated.

By way of derogation from point (b), where it is established between the counterparties that variation margin cannot consistently be provided on the same day on which it is calculated, the legal, supervisory and enforcement arrangements of Australia shall also be considered as equivalent to the requirements of Article 11(3) of Regulation (EU) No 648/2012 where variation margin is provided within 2 working days of its calculation and the margin period of risk used to calculate the initial margin is adjusted accordingly.

Article 3

This Decision shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

Done at Brussels, 5 July 2021.

For the Commission
The President
Ursula VON DER LEYEN
