HONG KONG MONETARY AUTHORITY
香港金融管理局

Banking Policy Department

Our Ref: B9/129C
B1/15C

18 March 2019

The Chief Executive
All Authorized Institutions

Dear Sir/Madam,

<u>Updates on SPM module CR-G-14</u>

I am writing to provide the following updates in relation to the HKMA's Supervisory Policy Manual (SPM) module CR-G-14 "Non-centrally Cleared OTC Derivatives Transactions - Margin and Other Risk Mitigation Standards", on (1) the comparability of the United Kingdom's standards after Brexit and (2) a recent statement published by the Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO) on the final implementation phases of the margin requirements.

1. Comparability of the United Kingdom's standards after Brexit

The SPM module CR-G-14 outlines our approach for determining the comparability of a jurisdiction's margin and risk mitigation standards with the provisions set out in the module. Under the substituted compliance treatment, the margin and risk mitigation standards of WGMR[1] member jurisdictions are deemed as comparable from the day the respective standards have entered into force in those jurisdictions. Footnote 24 of SPM module CR-G-14 lists the jurisdictions deemed comparable by referring to the European Union (EU) and all the non-EU WGMR member jurisdictions. This wording would currently not cover the United Kingdom (UK) after its planned withdrawal from the EU.

It is however the HKMA's intention to maintain the UK's status as a deemed-comparable jurisdiction in the context of SPM module CR-G-14, independent of its EU membership status. Footnote 24 would therefore be revised to specifically cover the UK once it withdraws from the EU.

[1] WGMR refers to the BCBS/IOSCO Working Group on Margin Requirements.

2. *Clarifications on the final implementation phases for margin requirements*

As you may be aware, the BCBS and IOSCO issued a joint statement[2] on 5 March 2019, providing two clarifications with respect to the BCBS/IOSCO framework for margin requirements for non-centrally cleared derivatives.

Considering market participants' potential need to amend derivatives contracts in response to interest rate benchmark reforms, the BCBS and IOSCO clarify that amendments to legacy derivative contracts pursued solely for the purpose of addressing interest rate benchmark reforms do not require the application of the margin requirements for the purposes of the BCBS/IOSCO framework. Implementing laws in individual jurisdictions may however differ on their specific requirements.

As regards the remaining phases of the framework's implementation in 2019 and 2020, initial margin requirements will apply to a large number of entities for the first time, potentially involving documentation, custodial and operational arrangements. The BCBS and IOSCO clarify that the BCBS/IOSCO framework does not specify documentation, custodial or operational requirements if the bilateral initial margin amount does not exceed the framework's EUR 50 million initial margin threshold. It is expected, however, that covered entities will act diligently when their exposures approach the threshold to ensure that the relevant arrangements needed are in place if the threshold is exceeded.

The above clarifications provided by the BCBS and IOSCO are applicable in the context of SPM module CR-G-14. Genuine amendments to existing derivatives contracts which are made to give effect to interest rate benchmark reforms will not be considered new contracts from the perspective of the HKMA's margin requirements. In addition, SPM module CR-G-14 does not specify a requirement for initial margin documentation, custodial or other related operational arrangements that must be in place before a covered entity crosses the HKD 375 million initial margin threshold.[3] Covered entities should however take necessary steps to prepare the documentation and other related arrangements well enough in advance to be in position to exchange initial margin when the threshold is exceeded and to protect exchanged initial margin with proper custodial arrangements.

The HKMA, in coordination with other BCBS and IOSCO members, will continue to monitor the effect of meeting the final stage of phase-in of the margin requirements.

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[2] https://www.bis.org/press/p190305a.htm

[3] The threshold is applied at the level of the respective consolidated groups to which the covered entities belong. For details, please refer to section 3.3 of SPM module CR-G-14.

If you have any questions on the HKMA's margin and risk mitigation standards for non-centrally cleared OTC derivatives, please contact Ms Eva Tung (2878 1228, eywtung@hkma.gov.hk) or Mr Lincoln Wong (2878 1271, llhwong@hkma.gov.hk).

Yours faithfully,

Daryl Ho
Executive Director (Banking Policy)

cc: The Chairperson, The Hong Kong Association of Banks
The Chairman, The DTC Association
FSTB (Attn: Ms Eureka Cheung)