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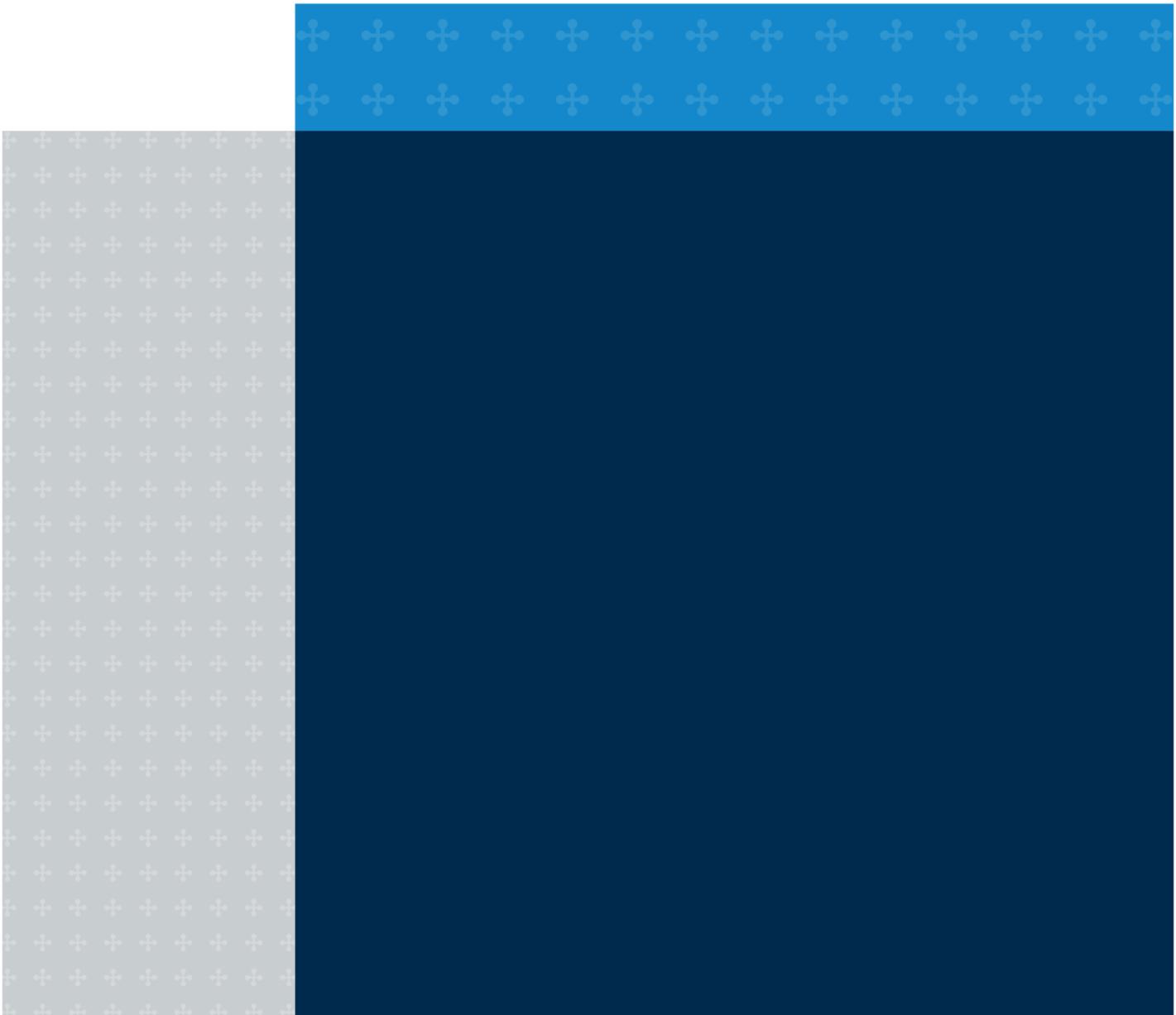
Publication



Policy Statement | PS14/21

# Margin requirements for non-centrally cleared derivatives: Amendments to BTS 2016/2251

June 2021





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## 1 Overview

1.1 This Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) Policy Statement (PS) provides feedback to responses to Consultation Paper (CP) 6/21 'Margin requirements for non-centrally cleared derivatives: Amendments to BTS 2016/2251'.<sup>1</sup> It also contains the PRA's and FCA's final policy, in the form of amendments to BTS 2016/2251.

1.2 This PS is relevant to PRA-authorized firms that are financial counterparties for the purposes of Article 2 of the European Market Infrastructure Regulation (EMIR).<sup>2</sup> In addition, this PS is relevant to all FCA solo-regulated entities and non-financial counterparties in scope of the margin requirements under EMIR.

### Background

1.3 In CP6/21, the PRA and FCA proposed to:

- change the implementation dates and thresholds for the phase-in of initial margin (IM) requirements;
- require the exchange of variation margin (VM) for physically settled foreign exchange (FX) forwards and swaps for specified counterparties only; and
- extend the temporary exemption from the margin requirements for single-stock equity options and index options until Thursday 4 January 2024.

### Summary of responses

1.4 The PRA and FCA received four responses to the CP. The responses were generally supportive of the proposals. One response requested a clarification to the text. This response also suggested a number of further amendments to the onshored Binding Technical Standards (BTS) that did not relate to the draft policy under consultation.

### Changes to draft policy

1.5 Where the final rules differ from the draft in the CP in a way which is, in the opinion of the PRA, significant, the Financial Services and Markets Act 2000 (FSMA)<sup>3</sup> requires the PRA to publish:

- (a) details of the difference together with a cost benefit analysis; and
- (b) a statement setting out in the PRA's opinion whether or not the impact on mutuals of the final rule is significantly different to the impact that the draft rule would have had on mutuals, or the impact that the final rule will have on other PRA-authorized firms.

1.6 In response to two comments, the PRA and FCA have made a change to the transitional provision to extend the eligibility of European Economic Area (EEA) Undertakings for the Collective Investment in Transferable Securities (UCITS) as eligible collateral. The specific change, and rationale, are set out in Chapter 2.

1.7 The PRA and FCA anticipates that the changes will improve legal certainty of participants in the UK derivatives markets. The extension of the transitional provision will provide certainty to market participants in the medium term, while enabling the PRA and FCA to consider the issue more fully,

1 March 2021: <https://www.bankofengland.co.uk/prudential-regulation/publication/2021/march/margin-requirements-for-non-centrally-cleared-derivatives>.

2 Unless stated otherwise, all references to regulations, technical standards, and rules should be read as to the UK versions.

3 Section 138J(5) and 138K(4).

and consult as necessary, on any longer-term proposals. The impact is not anticipated to be different for mutuals.

### **Implementation**

1.8 The requirements will be effective on publication of this PS, which includes the final technical standards instrument by the PRA and FCA.

1.9 The policy set out in this PS has been designed in the context of the UK having left the European Union (EU) and the transition period having come to an end. Unless otherwise stated, any references to EU or EU-derived legislation refer to the version of that legislation which forms part of retained EU law.<sup>4</sup>

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<sup>4</sup> For further information, please see <https://www.bankofengland.co.uk/eu-withdrawal/transitioning-to-post-exit-rules-and-standards>.

## 2 Feedback to responses

2.1 Before making any proposed rules or standards instruments, the PRA and FCA are required by FSMA to have regard to any representations made to them, and to publish an account, in general terms, of those representations and their feedback to them.<sup>5</sup>

2.2 The PRA and FCA have considered the responses received to the CP. This chapter sets out the PRA's and FCA's feedback to those responses, and final decisions.

2.3 The PRA and FCA proposed to align the initial margin phase-in deadlines and thresholds to those in the Basel Committee on Banking Supervision (BCBS) and International Organization of Securities Commissions (IOSCO) standard (as amended). All respondents were supportive of the proposal. One respondent supported the alignment to international thresholds, while reiterating previously-raised concerns about whether phase six delivers the intended regulatory outcome.

2.4 The PRA and FCA proposed to amend the application of the VM requirements for physically settled FX forwards and swaps. The requirement to exchange VM would only apply to firms that are 'institutions' as defined in Article 4(1)(3) of the Capital Requirements Regulation (CRR) (or for third-country firms, would meet the definition of 'institution' if established in the UK). All respondents supported the proposed amendment.

2.5 The PRA and FCA proposed to extend the temporary exemption for single-stock equity and index options until Thursday 4 January 2024. There were three responses to this proposal. While all were supportive, one respondent noted the potential for firms to use derivatives to structure economically equivalent transactions, while avoiding the margin requirements. The PRA recognises the potential for restructuring within financial markets. The issue of avoidance and arbitrage is not unique to this amendment, and the PRA monitors market developments through its horizon-scanning work programme and detailed reviews of firms' risk profiles. One respondent proposed a clarification to the text, requesting the exact date of expiry of the exemption be used in the Binding Technical Standard. This proposal has been adopted.

2.6 After considering the responses, the PRA and FCA have decided to maintain the draft policy as consulted on, except for the drafting change identified in paragraph 2.5.

### Feedback out of scope of the CP proposals

2.7 Two respondents proposed a number of other amendments to the BTS that did not form part of the CP. Notably:

- Two respondents requested that the PRA and FCA expand the collateral eligibility criteria in the BTS to include EEA UCITS. One respondent also requested consideration be given to UK, EU, and US money market funds.
- One respondent requested that the PRA and FCA broaden the exemption to the margin requirements for central counterparties (CCPs) authorised as a credit institution in the UK, to a broader range of CCPs.
- Two respondents requested that the PRA and FCA exclude non-dealers from the application of the back-testing and internal model governance requirements.
- One respondent requested that the PRA and FCA provide relief from the clearing obligation and

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<sup>5</sup> Sections 138J(3) and 138J(4) of FSMA.

margin requirements for new contracts, where the new contract results solely from efforts to effect benchmark reform and replace reference rates. This includes as part of a compression exercise.

- One respondent requested that the PRA and FCA align post phase-in compliance dates for IM with the BCBS-IOSCO framework.

2.8 With respect to the first point, the respondents suggested that smaller market participants (for example asset managers and fund managers) may be disproportionately affected by costs imposed by the removal of the use of EEA UCITS from the end of March 2022.

2.9 The PRA has given due regard to the potential challenges faced by firms on the limitation of scope of collateral eligibility, and the confluence of the extended implementation phases. The PRA and FCA have therefore amended the specific transitional provision in the final UKTS, which temporarily allows the continued use of EEA UCITS as collateral. The transitional provision will now last until end-December 2022.<sup>6</sup> The extended period will also provide the PRA and FCA with sufficient time to further consider the relative merits of these challenges for firms. The PRA and FCA intend to consult in Q1 2022 on the end-state requirements.

2.10 The PRA considers that the relief provided by extending the specific transitional provision for EEA UCITS mitigates some of the adverse impacts of the final IM implementation phases proposed in the CP. Further, the provisions are not obligatory; firms remain free to cease acceptance of EEA UCITS currently, and during the extended transitional, if they so choose. As such, the PRA considers there will be no additional costs imposed on firms from this extension, and therefore the extension to the transition is consistent with the PRA's primary and secondary objectives.

2.11 With regard to the response in relation to compression and Libor transition, the FCA has previously clarified its position on the treatment of legacy contracts that are amended solely for the purpose of introducing fallbacks in the context of Libor transition.<sup>7</sup> The FCA will consider whether any further clarification is required in this context.

2.12 The PRA and FCA note that the other responses are outside the scope of the consultation, and are therefore providing no further feedback. However, the PRA may consider future policy development in these areas.

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<sup>6</sup> Implementation Period completion day is defined as 11pm on Thursday 31 December 2020 (the close of the transition period as set out in the EU (Withdrawal Agreement) Act 2020).

<sup>7</sup> <https://www.bankofengland.co.uk/-/media/boe/files/minutes/2019/rfr-november-2019.pdf?la=en&hash=69418FFD6A88763B029F8C0AA50CCDEB173BB885>.

## Appendices

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- 1 **PRA STANDARDS INSTRUMENT: THE TECHNICAL STANDARDS (BILATERAL MARGINING) INSTRUMENT 2021**, available at: <https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2021/june/ps1421app1.pdf>

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  - 2 **FCA STANDARDS INSTRUMENT: THE TECHNICAL STANDARDS (BILATERAL MARGINING) INSTRUMENT 2021**, available at: [https://www.handbook.fca.org.uk/instrument/2021/FCA\\_2021\\_21.pdf](https://www.handbook.fca.org.uk/instrument/2021/FCA_2021_21.pdf).
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