



8 March 2021

Mr Andrew Alexandratos
Australian Prudential Regulation Authority
Sydney NSW
Australia

By email: andrew.alexandratos@apra.gov.au

Dear Andrew

LIBOR transition discrepancies in timeliness of reconciliations – CPS 226

The Australian Financial Markets Association (AFMA) and International Swaps and Derivatives Association (ISDA) are joining together, and at the request of the IBOR Transformation Australian Working Group, to present a request on behalf of our members with regard to the issue of timeliness in resolving portfolio reconciliation discrepancies under CPS 226 when dealing with legacy swaps for the purposes of transitioning from LIBOR.

In December 2020, the issue was raised in a liaison meeting with you and a follow up request in writing was promised. This letter follows up on this discussion and makes a request for further clarification of the portfolio reconciliation obligation under paragraph 82 of CPS 226.

For risk mitigation, CPS 226 requires resolution of discrepancies when reconciling portfolios to be done in a timely manner. In the US, the issue of timely reconciliation of portfolio was raised by the Alternative Reference Rates Committee (ARRC) with the Commodity Futures Trading Commission (CFTC). As such the CFTC has granted no-action relief from this requirement for amendments

to legacy swaps to accommodate fallbacks to alternative benchmarks¹. As mentioned in the CFTC letter, in certain circumstances, market participants may book Fallback Amendments or Replacement Rate Amendments² to their pre-transition swaps differently and at different times, creating potential discrepancies across counterparties' books that will appear in the reconciliation processes. Accordingly, ARRC requested clarification that swap dealers may engage in good faith compliance efforts to resolve any such discrepancies during a transitional phase. The CFTC letter provided relief for a failure to comply with the discrepancy resolution timing requirement of the relevant CFTC portfolio reconciliation rules.

While footnote 8 and 12 of CPS 226 address amendments for benchmark transition from the point of view of variation and initial margin, it does not expressly address the impact of benchmark related amendments on the risk mitigation requirements. Specifically, it is unclear whether the accommodation in footnote 8 and 12 could be implied to also relate to the requirement under paragraph 81 of CPS 226 and the timely resolution obligation under subparagraph 82 (b).

It is noted that Paragraph 82 (b) provides that the policies and procedures of an APRA covered entity must be designed to ensure the process or method of portfolio reconciliation is agreed upon with its counterparties and designed to identify and resolve discrepancies in the material terms and valuations in a timely manner.

Paragraph 83 of CPS 226 further provides that:

An APRA covered entity must conduct portfolio reconciliation with a scope and frequency that reflects:

- a) the nature and extent of its non-centrally cleared derivative activity;*
- b) the materiality and complexity of the risks it faces;*
- c) global regulatory standards imposed on similar institutions for similar transactions; and*
- d) market practice and industry protocols in the relevant derivative markets.*

¹ [See CFTC Staff Letter No. 20-23](#) regarding "Revised No-Action Positions to Facilitate an Orderly Transition of Swaps from Inter-Bank Offered Rates to Alternative Benchmarks" dated August 31, 2020.

² CFTC Letter 20-23 defines "Fallback Amendment" as an amendment to a swap solely for the purpose of including such fallbacks triggered only by permanent discontinuation of an IBOR or determination that an IBOR is non-representative by the benchmark administrator or the relevant authority in a jurisdiction. "Replacement Rate Amendment" is defined as an amendment under which some market participants may choose to voluntarily convert IBOR-linked uncleared swaps to alternative reference rates prior to any permanent cessation of the applicable IBOR or determination that a rate is non-representative by the benchmark administrator or the relevant authority in a jurisdiction.

A general reading of paragraph 83 may suggest that a delay in resolving discrepancies in material terms and valuations identified in portfolio reconciliation because of the amendments to their pre-transition transactions as a result of transitioning to an alternative reference rate, might be in the spirit of the provisions of CPS 226, particularly in the light of subparagraph 83(c) and the CFTC's accommodation. Nevertheless, to put the matter beyond doubt the Associations request that APRA clarify that such a delay to comply with the discrepancy resolution timing requirement set out in subparagraph 82(b) of CPS 226 is acceptable and not a breach of the obligation.

Thank you for your consideration of this request. The Associations would be pleased to discuss this request further at your convenience. Please do not hesitate to contact Jing Gu, Head of Legal, Asia Pacific, ISDA at JGu@isda.org or David Love, General Counsel and International Adviser, AFMA at dlove@afma.com.au.

Yours sincerely,



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