OSLO CLEARING HEARING COMMENTS TO
EBA Discussion Paper on Draft Regulatory Technical Standards on the capital requirements for CCPs under the draft Regulation on OTC derivatives, CCPs and Trade Repositories.

(EBA/DP/2012/1)

Introduction

This document contains the hearing comments from Oslo Clearing ASA. Oslo Clearing is a clearinghouse for equities, derivatives and security lending product as well as a member of EACH, the European Association of Central Counterparty Clearing Houses. EACH has submitted hearing comments to which all members adhere and we have chosen to incorporate the EACH answers in our document. Oslo Clearing references the EACH answers throughout the document.

Oslo Clearing would express its concern with respect to a large number of requirements that is conducive to raise the cost of clearing. The large number of draft technical standards that are required within a short time frame also poses a challenge with respect to carving out a set of standards that adequately address the process of clearing et al. In our view, the ESA's should be given more time to define the technical standards.

Oslo Clearing has not been able to allocate necessary resources to answer the questions in this discussion paper, due to competing discussion papers and draft regulation submitted at the same time, but also due the short time frame given to provide answers to the questions from EBA. Oslo Clearing provides answers, where deemed relevant, else we support the hearing comments from EACH.

Answers to the questions from EBA

Q1. Do you support this approach to capital requirements?

Oslo Clearing does not oppose the main principles laid down for requiring capital for the non-clearing activities of a CCP. However, we draw your attention to the fact that most CCP's in the EEA are "single-risk" entities, implying that their business is the one of clearing. For this purpose the CCP holds capital against its largest exposures, and will have stricter requirements to do, cf. EMIR art. 41, compared to the CPSS-IOSCO principles.

Further, the recent financial crisis has demonstrated that CCP's have been able to perform their obligations, at the same time as handling default situations, without incurring any losses. Resources from clearing members, but also the funds of the CCP have not been applied.

Organisational and operational requirements for a CCP are high, and will become even stricter under EMIR. CCP's already have conservative investment policies, and EMIR art. 44 imply even stricter policies.

Thus, Oslo Clearing perceives setting capital requirements for non-clearing activities and operational risk to be excessive. However, the requirement now forms part of EMIR, but applying requirements for credit institutions to CCP's seem out of proportion, since, as mentioned above, CCP's have a materially different risk model.

As a point for clarification we seek guidance on how to consider the minimum initial capital of EUR 7,5 mill., defined by EMIR art. 12.1, in relation to the methodology described by paragraph 6 in the discussion paper, where the capital is required to be the higher of two amounts:

- Its operational expenses during an appropriate time span for winding-dow or restructuring its activities, and
- The sum of capital requirements for the overall operational risk and for credit, counterparty and market risks stemming from "non-clearing activities" it carries out.

Does the above imply that the EUR 7,5 mill. are included in the two requirements calculated following the above methodologies, or shall the EUR 7,5 mill. come in addition?

Oslo Clearing further refers to the comments by EACH, below:

- EACH welcomes that for the "clearing activities" no specific capital requirement is to be added in the proposal on top of the financial resources as requested in EMIR Article 41. EACH agrees that the economic risk of the CCP in the clearing activities is limited to such funds. In that context, EACH wants to point out that the same treatment for these positions should be valid for CCPs operating also with a "banking license" under CRD and that this should be implemented (mirrored) in the banking framework as well.

- As the coverage of x month expenses as a minimum coverage is included in the current CPSS-IOSCO principles draft, we understand, that this component will be one elementbit of the requirements in any case and we also accept the general approach of having equity in the higher amount of x month operating expenses and the result of a more comprehensive approach (see below). hHowever, in case of full usage of the banking rules and taking into account the minimum equity of 7.5 million €, the usage of x month expense as an additional minimum coverage seems not to be appropriate. The capital coverage for operational risk and the add-on for market risk in that case seem to be sufficient. This might be a topic for alignment also on CPSS-IOSCO level .

- EACH also agrees in principle to the proposal to use the Banking approach for CCPs. But, neither should there be differing (if not clearly derived from EMIR / CRD) and explicitly not more stringent rules nor should the basis of proportionality included in the banking rules be left aside. (see below)

EACH would like to highlight, that the time given was not sufficient to develop an own model. However some EACH members propose the following model to reach proportionality, which is demanded in EMIR. Nevertheless EACH would like to emphasize the existence of other equally valid approaches, which should be chosen flexibly by the various CCPs:

- To include an "operating cost" only model for CCPs that do not take clients' money themselves (cash administered by a settlement / collateral agent) and do not operate additional business which (i) requires a license for regulated services or (ii) – according to the competent authority – adds material risk to the CCP. This would follow the logic of article 4 (8) CRR which excludes certain investment firms as defined in MiFID from the application of CRR rules according to their low risk profile. Such CCPs should have 6 month operating expenses (to be in synch with CRR: one half (6 month) fixed overheads of the CCP for the preceding year [Article 92 (1) CRR]).

- To include a "higher of" model for those CCPs that do not take clients' money themselves (cash administered by a settlement / collateral agent) but operate additional business which (i) requires a license for regulated services or (ii) – according to the competent authority – adds material risk to the CCP. Such regulated service should not be services which require a banking license and hence lead to full CRR application in it. This would follow the logic of Article 90 – 92 of CRR (i.e.: Such CCPs should follow the rules as laid down in article 91 (2) CRR. CCPs subject to the "operating cost" only model should be allowed to switch to the "higher of" model.
- To use the higher of" model also for large CCPs in case they do not fulfil the above mentioned criterions. "Large" being defined as earning gross revenues (in the sense of the relevant indicator for operational risk in CRR) of 100 mn.
- To include a "CRD" only model to the CCPs those take clients' money themselves or are subject to CRR due to other activities.

The proposed model is aligned with the proportionality rules of CRD as:

- Small CCPs, that do not take clients' money do not face substantial credit (and market) risk should not be forced to use the banking approach (even not to calculate it for comparison reason). As the model is less complex, a higher period of cost is to be covered.
- The "higher of" is imposed to those more "risky" CCPs that still do not take clients' money. This is in line with CRR. Those institutions are obliged to calculate the banking approach. As they do not take clients' money, the credit and market risk is supposed to be low, but the capital charge for operational risk needs to be covered. As the operational risk for CCPs is supposed to be lower than those of classical banks (due to higher straight through and a limited, but risk focussed business model including the lines of defence for the core activities) it is proposed to follow the 3 month approach of article 92 CRR instead of the 6 month approach for the small CCPs.
- The banking rules only approach is followed as the risks are driven to some extend from credit and market risk (though according to investment guidelines out of EMIR supposed to be limited) and in line with CPSS-IOSCO recommendation 15 – key consideration 3 ("Capital held under international risk based capital standards should be included where relevant and appropriate to avoid double regulation). The avoidance of double regulation is the driving moment and to our understanding both risk adequate as well as in line with EMIR requirements and CPSS-IOSCO principles. We cannot read out of EMIR Article 12 (2) the requirement to determine the timtime span for orderly winding-down nor read in CPSS-IOSCO, that the international capital standards cannot replace the minimum period approach. Furthermore, we feel that the proposed approach is proportional to the risks of the CCP as requested by EMIR Article 12 (2).

Q2. Do you consider there to be any alternative approach which is more appropriate that would be consistent with Article 12 of the Regulation?

In our opinion, EBA should consider alternatives.

EACH comment:

We have outlined in our answer to question 2 our slightly modified approach. To our understanding this is compliant with EMIR Article 12, CPSS-IOSCO principle 15 and in synch with CRR. It should be noted though, that we strongly recommend to include the additional features (capital deduction for positions out of EMIR Article 44 (1a) and EMIR Article 41 (1) (best done by including as a risk position in CA 2 as proposed in the ITS in CP50)) in the final ITS on COREP under CRR.

2. Operational expenses for winding-down or restructuring

Q3. Which criteria do you take into account for estimating the appropriate time span for orderly winding down or restructuring of the CCP's activities?

We consider the criteria being the time necessary for an alternative clearing solution to replace the existing one, which is winding down.

Further, contracts maturing past the "switch over" date, may either be terminated in accordance with the rules of the CCP winding down, but could also as an option potentially be transferred to the new clearing solution.

Each CCP should be able, in co-operation with co-operating trading venues, CSD's etc., to determine the time span needed, and this may vary from CCP to CCP.

We support the EACH comment, below:

The time span for winding down or restructuring a CCP will differ significantly depending on size, product portfolio, number of trading venues served, organization (especially IT landscape) and the local law (insolvency law). In fact, it can only be determined on the market conditions and cause for winding down at the point in time winding down is necessary. However, we do not see any sense in determining the period as it also is not requested by EMIR (see our proposal above)

Q4. What is your estimation for the number of months necessary to ensure an orderly winding-down or restructuring of the CCP's activities?

Oslo Clearing supports the EACH comment below:

EACH believes that there is no uniform approach (one size fits all) in determining the time required for restructuring or winding down.

Q5. Do you think that a minimum list of items to be included in the operational expenses could be useful, such as the IAS 7?

Oslo Clearing supports the EACH comment below:

EACH questions the adequacy of IAS 7 in that context as IAS 7 deals with cash flow. As not all CCPs - especially smaller CCPs - prepare accounts according to IFRS, EACH believes it would be an additional burden on those CCPs to prepare a transition calculation from local GAAP to other requirements like IAS 7. In principle the items listed

in the Banking Accounting Directive are suitable. As also just a minority of CCPs is subject to this accounting standard, we nevertheless do not suggest imposing this. As far as CCPs annual statements are subject to an audit by an independent auditor the on-going operational expenses (not including extraordinary items) according to local GAAP should be considered adequate for this calculation. We do not see any reason to specify this and refer in this regard to the wording of CRR Article 92.

3. Capital requirements for operational risk

Q6. How do you currently measure and capitalise for operational risk?

Oslo Clearing measures operational risk based on the severity and potential monetary impact of all deviations from operating procedures. The monetary value required for such deviations are considered within the total capital of Oslo Clearing.

Q7. Do you think that the banking framework is the most appropriate method for calculating a CCP's capital requirements for operational risk? If not, which approach would be more suitable for a CCP?

EACH believes that the banking framework is an appropriate method for calculating the capital requirement for operational risk. For small and medium size CCPs we however belief, that the minimum equity requirements from EMIR Article 12 (1) and the x month operational cost proposed for winding down time should be sufficient to cover operational losses in a going concern situation. (see our proposal above). This is following the principle of proportionality.

Q8. What would be the cost of employing the basic indicator approach set out for banks for the calculation of your capital requirements for operational risk?

Seen in isolation, Oslo Clearing deems the cost to be small. However, Oslo Clearing is more concerned about the sum of requirements that are imposed on to CCP's, where each separate measure represents a small cost, but where the total implies a substantial burden. This is conducive to driving up the cost of clearing.

Please refer to our comments to the Draft on technical standards released by ESMA on the 16 February 2012.

Q9. Do you think that the Basic Indicator Approach set out for banks is appropriate for CCPs?

We support the comment made by EACH:

EACH believes that the basic indicator approach is appropriate for CCPs, like any other of the approaches allowed under the banking framework.

Q10. In your view, which alternative indicator should the EBA consider for the Basic Indicator Approach? (Please elaborate why such indicator would be more appropriate for CCPs)

We support the comment made by EACH:

EACH favours no other indicator. Nevertheless it should be ensured, that the regulation allows flexibility in introducing new alternatives. As the BCBS debate on Basel II has spent years in order to determine an appropriate indicator, we do not feel in a position to repeat these debates with valuable outcome.

Q11. In your view, with regard to the Standardised Approach, which different lines of business or type of products can be relevant for CCPs' operational risk?

We support the comment made by EACH:

- EACH believes that there is no need to allocate the CCPs business artificially to a particular business line. In general, the CCP business is not comparable with any real banking activity and from an operational perspective less risky (straight through, highly risk averse and with sophisticated risk management tools).
- The BIA "relevant indicator" seems designed to the banking sector and does not fit CCP activities. But since the rational for operational risk measurement is not sound, it will be difficult to use sound arguments. In the banking industry the indicator is a proxy of a banking product concept. For CCPs some clarification would help.
- EACH questions if CCPs globally hold more or less risk than the banking activity, since banks using BIA are using a 15% rate. The business lines for the Standardised Approach are clearly designed to banking, not to CCPs, so a provisional solution should be set in order to accommodate (new) CCP business within the business lines. CCP activities differ from banking "payment and settlement" activity with an 18% rate.
- A higher weight than 15 % seems therefore not being risk adequate. It is therefore most likely, that the standardised approach is not used by the vast majority of the CCPs. Nevertheless, it should be feasible. (Note, the business lines receiving 12 % only are not relevant for CCPs but the rate of 12 % is closer to the inherent risk of CCPs than the 15 % rate).

Q12. Do you think CCPs should be allowed to calculate the capital requirements for operational risk with an internal model, as in the advanced measurement approach?

We support the comment made by EACH:

Yes, EACH believes, that it should be allowed to calculate the capital requirements for operational risk with an internal model. EACH is in favour to offer full banking rules on capital with all choices given to the banks.

Q13. Which other approaches should the EBA consider for operational risk measurement?

We support the comment made by EACH:

EACH favours no other approach. Nevertheless it should be ensured, that the regulation allows flexibility in introducing new approaches.

4. Capital requirements for credit and market risks stemming from "non-clearing activities"

Q14. How do you currently measure and capitalise for credit, counterparty credit and market risk stemming from "non-clearing activities"?

Please refer to our answer to question 6, the same principle applies: the credit and market risk for "non-clearing activities" are considered within the total capital of Oslo Clearing.

Please see comment made by EACH:

> The Additional Capital is intended to cover on the one hand against market risk, credit risk and counterparty credit risk arising from investment activities and other non-clearing activities; and, on the other hand, to mitigate against operational risk arising from all activities of a CCP (including non-clearing and clearing ones). The term "clearing activity" and "CCP" in EMIR seems to relate to financial instruments/financial markets. We also clear non financial products (physical commodities). We would therefore like to clarify that clearing of non financial markets/instruments is still regarded as clearing (if same organizational measures as for clearing of financial markets/instruments are applied) and therefore can be covered by the financial resources in EMIR articles 39 and following and shall not be covered by Additional Capital.

Q15. Do you think that the banking framework is the most appropriate method of calculating a CCP's capital requirements for credit, counterparty credit and market risk stemming from "non-clearing activities"? If not, which method would be more suitable for a CCP?

The requirements and technical standards set for the investment policy of the CCP are of such restrictive nature, that we must assume the quasi-absence of credit and market risk.

Could CCP's have access to central bank deposits overnight at a reasonable rate of remuneration, we believe the issue of measuring credit and market risk becomes obsolete.

Q16. What would be the cost of employing Standardised Approach methods for the calculation of your capital requirements for credit, counterparty credit12 and market risk stemming from "non-clearing activities"?

Please see our answer to question 8.

Q17. In your view, are the Standardised Approach methods appropriate for the calculation of credit, counterparty credit and market risk a CCP faces stemming from "non-clearing activities"?

Please refer to our comment to question 1, however if a banking capital approach is to be applied for CCP's we support the comment made by EACH:

> EACH believes the standardized approach is adequate. However under Basel III regulation the risk-weight will be increased from 8% to up and around 13%. It needs to be clarified, if the current Basel II or the future Basel III rules should apply. In line with the general approach to follow the banking rules to the extent possible, we would

support to follow Basel III, i.e. to have the CRD IV rules in place (for solvency only). However, clear rules need to be in place to monitor future developments and to decide on a case by case basis, which new / revised rules are to be applied in case future changes will happen.

Q18. Do you think that CCPs, which concentrate risks stemming from derivatives, should be allowed to calculate their capital requirements for credit, counterparty credit and market risk using internal models?

Oslo Clearing assumes that a CCP clearing derivatives shall hold capital in accordance with EMIR art. 41. Derivatives clearing is considered a core clearing activity, we join EAC in asking for clarification on this issue. The EACH comment is displayed below:

EACH asks for clarification of that question. However EACH would support the approach if the internal models are used by a CCP clearing any products. EACH would not support to limit the approach for derivatives clearing only.

Q19. In your view, which assets held by a CCP should be better capitalised with a market risk treatment?

We support the comment made by EACH:

EACH believes that the existing approaches available in the banking framework for market risk are adequate. In total, market risk will be most likely marginal anyway. This is a consequence of the particular risk averse and highly "liquid" business model of a CCP.

Q20. In your view, which other approaches should the EBA consider for credit, counterparty credit and market risk measurement?

We support the comment made by EACH:

EACH favours no other approach. Nevertheless it should be ensured, that the regulation allows flexibility in introducing alternative approaches.

Q21. What is your view on the notification threshold? At which level should it be set?

Oslo Clearing does not see that such a requirement is sensible. The credit and market risk elements in "non-clearing activities" are negligible, operational risk is well taken care of, in respect of high standards for internal processes.

Should there be a threshold it should be set at 100 pct.

The EACH comment is displayed below:

A threshold of 105 % should be implemented in order to be obliged for daily calculation. However, as for the banks this should not lead automatically to reporting obligations. In order to reflect the specific role of CCPs EACH nevertheless considers a reporting obligation being useful, if the breach of the 105 % boundary occurs either several (say 5) days in a row or a dedicated number of days within a given timeframe (e.g. 10 times within 1 month)

Q22. In your view, in which case should restriction measures be taken by the competent authority once the notification threshold is breached?

Should there be a threshold, then we support the comment made by EACH:

> EACH believes that restriction measures should be taken if either threshold breaches are reported frequently (more than 3 times within 12 month) or a threshold breach persists for more than 15 days in a row. Measures are to be taken in case of breaches of the minimum requirements.
>
> Text 33 states that measures should be taken by the competent authority if a CCP does not hold sufficient capital. This is in our view contradictory to Text 35 where the competent authority should take measures already if the information threshold is breached. This is also in contradiction to principle 15 key consideration 5 of the CPSS-IOSCO principles where measures are required if the minimum capital is not achieved. As the measures will depend on the individual circumstances it should be left to the competent authorities discretion to decide measures in case the information threshold is breached or the capital is not sufficient. However the measures taken in case the information threshold is breached should be mainly of informative fashion.

Q23. Please provide the sum of the operational expenses during an appropriate time span for winding down or restructuring a CCP's activities based on the approaches specified below.

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Q24. Please provide the capital requirements for operational risk.

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Q25. Please provide the capital requirements for credit risk stemming from "non-clearing activities".

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Q26. Please provide the capital requirements for counterparty credit risk stemming from "non-clearing activities".
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Q27. Please provide the capital requirements for market risk stemming from "non-clearing activities".

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