TECHNICAL STANDARDS BY ESMA – HEARING COMMENTS FROM OSLO CLEARING ASA

Draft on technical standards released by ESMA on February 16th 2012.

Introduction

This document contains the hearing comments from Oslo Clearing ASA. Oslo Clearing is 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. However, Oslo Clearing has opinions on central questions, to which we provide our views.

Oslo Clearing is concerned with the following central issues relative to the technical standards being developed by ESMA:

1. As a general comment, EMIR and the views presented by ESMA may end up having the opposite effect of what is intended by the regulation, meaning too high requirements for mandatory clearing, too many exceptions so that mandatory clearing is avoided and too strict requirements, with a high degree of prescription – thus, little effect on increasing financial stability through mandatory clearing, but all at a higher cost for the users of CCP's
2. EMIR, but also some of the views presented by ESMA are more strict than international requirements (CPSS-IOSCO) or diverge from standards being applied in jurisdictions outside the EEA. This, in our opinion opens for regulatory arbitrage.
3. The general high level of prescription leaves less room for CCP's to decide on the optimal way of organising its activities, but even more so decide on risk models and parameters that best capture risks in the market. A consequence of the high degree of prescription set by ESMA, is that CCP's may end up not have adequate risk coverage. The implication is that ESMA is overtaking the responsibility for margin models for all CCP's across the EEA. We thus assume that ESMA is prepared to bear the consequences of potential misspecification of risk models and defining risk parameters at inadequate levels

Clearing obligation (art. 3)

<u>Contracts having a direct, substantial and foreseeable effect within the EU</u>

Q1: In your views, how should ESMA specify contracts that are considered to have a direct, substantial and foreseeable effect within the EU?

The intention from G-20, which is being implemented through EMIR is to achieve financial stability and ensure that market events have as little impact on the economy as possible, i.e. avoiding contagion effects.

Since (severe) market events are difficult to predict, it is even more difficult to predict the (next) origin of such events. The recent financial crisis originated from a highly leveraged housing market, where tailored derivatives formed a decisive part.

It is the view of Oslo Clearing that ESMA should have a broad view on OTC derivatives when deciding mandatory clearing, in order to (potentially) be ahead of the next financial crisis.

We would further support the following comments made by EACH, stating:

EACH Comment: Art. 3/4- Q1-9 Clearing Obligation / Clearing Obligation Procedure

- It has to be taken into account that the outlined detailed specification of derivatives subject to the clearing obligation will open a loophole for similar products, which do not exactly fit to all details specified. By ignoring this important point these new invented products will stay non-CCP cleared and are not subject to the regulation.
- It is imperative for the functioning of EMIR that there is a high economic incentive to use CCP clearing for derivatives (e.g. by capital requirements). A standalone obligation will not solve the problem.
- In the case CCP cleared trades are economically more attractive compared to non-CCP cleared trades investors, market participants and infrastructures have a common interest to organize a CCP cleared market even if an obligation is in place or not.
- EACH is in favour for more general criteria for OTC derivatives to be subject to the clearing mandate to avoid that the obligation can be circumvented easily by changing minor details of a contract.
- Therefore EACH recommends targeting a 3-digit number of general classes of derivatives and in questions to use exemptions instead of creating 100.000 detailed classes of OTC derivatives subject to the clearing obligation, which will create another million of OTC derivatives not fitting to the clearing obligation criteria.

Q2: In your views, how should ESMA specify cases where it is necessary or appropriate to prevent the evasion of any provision of EMIR for contracts entered into between counterparties located in a third country?

The problem posed by this question presupposes entering into a level of complexity and detail. The position of Oslo Clearing is that a high level of prescription should be avoided, and ESMA should focus on criteria based standards.

The answer to the question resides in harmonising rules for OTC clearing and standards for CCPs on a global level, i.e. more effort is required to solve the extra-territorial issues.

Please confer with the comments from EACH.

Types of clearing arrangements

Q3: In your views, what should be the characteristics of these indirect contractual arrangements?

In Oslo Clearing's opinion, ESMA should focus on the contractual relationships. A CCP will have a contractual relationship with its clearing members, thus in this setting no customer of the clearing member is known to the CCP, and the CCP has no contractual relationship to those customers and can consequently not can take any responsibility for those customers, such as segregation or portability.

Customers that require segregation (but also portability) shall enter into a separate agreement with their clearing member and the CCP (tri-party agreement) in order to establish a contractual relation, whereby the CCP is legally in a position, not only to identify the positions and assets of the customer, but also protect these positions and assets from the default of the clearing members by potentially porting the positions to another clearing member. In a worst case scenario, Oslo Clearing would close-down the customers positions, using available assets, but then returning any excess funds to the customer (here in the meaning segregated client) after the wind-down.

The tri-party agreement, described above, shall commit the clearing member to be mutually responsible with the customer, meaning that any excess funds will remain the property of the customer, but any loss incurred on the customer account may be absorbed by the clearing member. Further, the tri-party agreement shall authorise the clearing member to act on behalf of the customer f.ex. in relation to posting sufficient collateral to the CCP at all times.

Clearing obligation procedure (art. 4)

Notification from the competent authority to ESMA

Q4: What are your views on the required information? Do you have specific recommendations of specific information useful for any of the criteria? Would you recommend considering other information?

The characteristics of OTC derivatives are that contracts tend to be tailored to the needs of the users of such contracts, and that information about volumes and liquidity is scarce, i.e. these products are not as transparent as those on a trading venue, and ESMA seems not taking sufficient consideration to this.

In our opinion, based on the notification requirements, we question the accuracy and the completeness of the information that will be provided to ESMA. We recommend softening the requirements, which would enable a more principle based approach on deciding mandatory clearing for any 'asset class'.

We are concerned, from the point of view of financial stability, that many relevant OTC derivative contracts may not be subject to mandatory clearing, which would contradict the intentions set out by the G-20.

Q5: For a reasonable assessment by ESMA on the basis of the information provided in the notification, what period of time should historical data cover?

Please refer to the answer in question 4, above. The more detail required, the longer time series are required. This is counterproductive to decide affirmatively on mandatory clearing.

The relevant issue is whether a CCP is able to demonstrate sound risk management for OTC derivatives with imperfect trading features. F.ex. is the CCP equipped with pricing and risk models that capture these imperfect features, are risk management techniques adapted to handle the products in question, etc.

Q6: What are your views on the review process following a negative assessment?

The procedure requires that market conditions change, or that there is new material information that could lead to a reassessment.

Oslo Clearing believes that there should be a procedure after negative assessment, where the competent authority could appeal the decision made by ESMA. This would imply that ESMA shall provide the full assessment to the competent authority in order for the national authority to ensure that all relevant factors have been examined (there could f.ex. exist local market conditions that have not been given sufficient weight in the assessment process).

Criteria to be assessed by ESMA under the clearing obligation procedure

Q7: What are your views regarding the specifications for assessing standardisation, volume and liquidity, availability of pricing information?

Please refer to answer provided to questions 4 and 5, above.

ESMA should endeavour to obtain mandatory clearing for as many 'asset classes' as possible, however the decision criteria should rely on CCP's being able to manage risks for such contracts. Issues such as lack of standardisation, little transparency relative to liquidity and volumes, but also difficulty to observe prices may be addressed by setting margin rates accordingly (meaning high margins).

Mark-to-model is acceptable in risk mitigation techniques for non-CCP cleared contracts, and these are subject to risk management standards equal or higher to those applied by a CCP. In the opinion of Oslo Clearing, when a CCP can demonstrate the ability to handle OTC derivatives with imperfect trade features, ESMA should decide affirmatively on mandatory clearing.

Public register available on ESMA website

Q8: What are your views, regarding the details to be included in ESMA Register of classes of derivatives subject to the clearing obligation (Article 4b)?

With reference to the answers provided by EACH, we are in favour of determining each class of OTC derivatives on a relatively broad basis – the register on the ESMA website should be designed in accordance with this.

The approach to decide on which OTC derivatives shall be submitted to mandatory clearing should be principle (or criteria) based.

Q9: Do you consider that the data above sufficiently identify a class of derivatives subject to the clearing obligation and the CCPs authorised or recognised to clear the classes of derivatives subject to the clearing obligation?

We believe that the data required are too detailed. We support points (a), (b) and (d) in paragraph 24, other information implies an exponential function with respect to which contracts to be identified. Point (c) may be useful, however given the number of underlying instruments, not only in Europe, but globally we deem the task of maintaining up-to-date information on the website to become extremely challenging.

The proposed level of detail in paragraphs 25 and 26 are sensible, however points (b) and (c) need to further clarification.

Non-financial counterparties (art. 5/7)

Criteria for establishing which derivative contracts are objectively measurable as reducing risk directly related to the commercial activity or treasury financing

Q10: In your view, does the above definition appropriately capture the derivative contracts that are objectively measurable as reducing risk directly related to the commercial or treasury financing activity?

The hedge exception enables the possibility to avoid clearing, however we would draw the attention of ESMA to the fact that if one party on the derivatives contract fails, the other party will loose its hedge, and may potentially incur an economic loss as a consequence. The hedging exception is not achieving the intention of the G-20.

We are not convinced that hedges qualifying under the IFRS-principles for hedge accounting, are purely done for hedging purposes. If hedge exceptions shall be allowed, they should only be so in accordance with paragraph 29. We suggest that the conditions in paragraph 30 are removed. Further the entity that seeks to use the hedge exception, should do so by clearly demonstrating the commercial nature of the hedge, in accordance with paragraph 29.

Clearing threshold

EACH Comment: Art 5/7 Q10-11 Non financial counterparties

- EACH is supportive to the approach to define a threshold for an economic group instead of each company. Also thresholds should be set across asset classes and not per asset class.

Q11: In your views, do the above considerations allow an appropriate setting of the clearing threshold or should other criteria be considered? In particular, do you agree that the broad definition of the activity directly reducing commercial risks or treasury financing activity balances a clearing threshold set at a low level?

Our concern is that mandatory clearing is potentially avoided with a clearing threshold. The use of the notional amount of the derivative contracts is simplistic and does not properly capture the embedded risk. Market values and the non-linear features of derivative contracts should be considered in establishing a threshold.

We support setting the threshold at a low level.

Risk mitigation for non-CCP cleared contracts (art. 6/8)

Timely confirmation

Q12: What are your views regarding the timing for the confirmation and the differentiating criteria? Is a transaction that is electronically executed, electronically processed or electronically confirmed generally able to be confirmed more quickly than one that is not?

The time lag for confirmation between the parties entering in to a derivative contract should be as short as possible. The confirmation process must be concluded at the latest within the end of the trading day in order handle corrections, cancelations and complaints, before any netting process takes place, if applicable.

Confirmation processes along with the above would then be comparable to CCP-standards.

EACH Comment: Art 6/8 Q12-22 Risk for non-CCP

- As outlined under Q1-9 CCP cleared trades have to be economically more attractive compared to non-CCP cleared trades to incentivise investors and market participants to use a CCP cleared market.

- If ESMA stays with the level of detail, which is applied on CCPs, it should also be applied on bilateral business, e.g. the risk management for non-CCP trades should get a comparable regime regarding margins, confidence levels, collateral and additional lines of defense.

Q13: What period of time should we consider for reporting unconfirmed OTC derivatives to the competent authorities?

In order to comply with the requirement of having risk management standards that are equal or higher to those applied by a CCP, unconfirmed OTC trades should not exist 'overnight', please refer to our answer in question 12.

Unconfirmed derivatives positions overnight, above certain thresholds (value and risk dependent) should be reported immediately to the competent authorities and be subject to sanctions (i.e. penalty)

Marking-to-market and marking -to-model

Q14: In your views, is the definition of market conditions preventing marking-to market complete? How should European accounting rules be used for this purpose?

We deem the definition to in paragraph 45 points (a) to (c) to be adequate. However, although independent validation is appropriate, there may occur situations that require immediate amendments to the pricing models. Further, the level of approval of pricing models seems excessive, since the proposal seems to indicate that approval by the board is required.

Q15: Do you think additional criteria for marking-to-model should be added?

No.

Reconciliation of non-cleared OTC derivative contracts

Q16: What are your views regarding the frequency of the reconciliation? What should be the size of the portfolio for each reconciliation frequency?

Reconciliation is practically done End-of-Day (EOD), which we believe to be a common standard in most markets, and with all participants.

Portfolio compression

Q17: What are your views regarding the threshold to mandate portfolio compression and the frequency for performing portfolio compression?

The gross volumes of derivatives contracts, that have the same contract properties, should serve as the starting point for portfolio compression. The frequency of portfolio compression should be a function of the contract maturities, performed on contracts with long maturities.

Dispute resolution

Q18: What are your views regarding the procedure counterparties shall have in place for resolving disputes?

The parties should have in place procedures for identifying and resolving disputes. Oslo Clearing has such procedures in place, and corresponding procedures should exist for disputes arising relative to non-cleared contracts. Main market principles should apply if possible, this is an advantage when submitting the trades for clearing, since there is one CCP appointed to set standards for the market, (also applicable under interoperable arrangements, one CCP defines standards for the other CCPs). There should not be any differentiation between different categories of participants.

Q19: Do you consider that legal settlement, third party arbitration and/or a market polling mechanism are sufficient to manage disputes?

Recourse to a third party, i.e. an arbitration court forms part of a CCP's rulebook, the corresponding should apply for uncleared derivatives. Contracts should thus have a clear reference to arbitration procedures.

Q20: What are your views regarding the thresholds to report a dispute to the competent authority?

A threshold should be defined, so as not to unnecessary encumber the competent authorities with contested issues of minor importance.

In the event of a dispute, both parties should, based on the fact they both agree that there is a dispute, report to the competent authority that there is a dispute.

Intra-group exemptions

Q21: In your views, what are the details of the intragroup transactions that should be included in the notifications to the competent authority?

Oslo Clearing notes that intra-group transactions will form an exemption from mandatory clearing, i.e. going against the intention of the G-20. There is substantial evidence of group structures that have not adequately managed defaults for daughter- or sister-companies.

To provide exemptions for intra-group transactions, more comfort would in our view be required, i.e. providing parental guarantees would not be sufficient, instead the group should at least provide an unconditional guarantee from independent highly rated (financial) institutions, to cover for potential events of default. Notification to the competent authority should provide details on the level of comfort.

Q22: In your views what details of the intragroup transactions should be included in the information to be publicly disclosed by counterparty of exempted intragroup transactions?

The analyst community would probably be interested in the asset classes that have been given the exemption, but also information about volumes and maturities.

CCP Requirements

Access to venue of execution (art. 5a)

Q23: What are your views on the notion of liquidity fragmentation?

Oslo Clearing refers to the EACH comment, see below.

EACH Comment: Art 5a Q23 Access

There are several adverse effects associated to fragmentation in financial markets:

- Fragmentation has a negative impact on oversight
  - E.g. regulators are concerned that fragmentation makes it harder to conduct effective market surveillance against market manipulation and abuse
- Fragmentation has negative risk implications
  - E.g. multiple interfaces between independent entities will put end-to-end operational stability at risk
  - In order to further attract flows, CCPs could start a race to the bottom in regards to risk management. To mitigate that it would increase the pressure to mandate same risk management measures and models for the CCPs. But in that case a monoculture of CCP risk management would arise, transmitting undesirable effects throughout the whole European network.
- Fragmentation is negative for investors due to worsened price discovery
  - E.g. Institutional investors consider that fragmentation makes it harder to find liquidity
- Fragmentation demands inter-linkage/ interoperability
  - A model with two or more clearing houses serving one market is economically less efficient. It would lead to pressure for interoperability for OTC derivatives. The risks of interoperability in derivatives are orders-of-magnitude greater than for cash equities, which was the rationale to ask for more research and impact assessments in that area.

Organisational requirements (art. 24)

Q24: What are your views on the possible requirements that CCP governance arrangements should specify? In particular, what is your view on the need to clearly name a chief risk officer, a chief technology officer and a chief compliance officer?

The CCP should be the one to decide on how to best establish an optimal organisational structure, which fits to the business conducted, but a structure that ensures independence of central risk and control processes. F.ex. the role of the compliance officer could be included in other functions, f.ex. together with the legal and regulatory functions of the CCP or within a group company, t. A CCP should be allowed to use shared functions within a group, f.ex. using a group compliance officer.

Q25: Are potential conflicts of interests inherent to the organisation of CCPs appropriately addressed?

There is a clear intention of avoiding potential conflict in the discussion paper. Rather than giving prescription on the organisational structure, we propose that the CCP is allowed sufficient flexibility to define an optimal organisation, subject to demonstrating that potential conflicts of interest are taken care of.

We recommend ESMA to take a more principle based approach, rather than regulating in detail.

Q26: Do the reporting lines – as required – appropriately complement the organisation of the CCP so as to promote its sound and prudent management?

Yes.

Q27: Do the criteria to be applied in the CCP remuneration policy promote sound and prudent risk management? Which additional criteria should be applied, in particular for risk managers, senior management and board members?

Yes. Oslo Clearing has no additional criteria to add.

Q28: What are your views on the possible organisational requirements described above? What are the potential costs involved for implementing such requirements?

Oslo Clearing does not have major issues with the requirements set forth in paragraphs 74 and 75. However, as a general comment, we would point to the fact that a CCP has a relationship to a clearing member, which we must assume is a professional and qualified counterpart. Thus, through all legal arrangements, due diligence processes, etc. we must assume that requirements set out in paragraphs 74 and 75 are met.

Disclosure of information in the level of detail proposed by ESMA seems somewhat excessive, and imposes an additional burden to the CCP, meaning that more resources will have to be allocated to maintain up-to-date information on the website of the CCP, thus representing an additional cost to clearing, that may be passed on to the users of CCP's.

Paragraph 75.h requires translation to the official language of the Member State where the CCP is established. A CCP is relating to professional counterparts, where we must assume that English is the language of choice. First, the requirement has an impact on the legal arrangements of a CCP, the CCP must decide that one version of the rulebooks and agreements shall be given precedence over the others, when more than one language is being used, so as to avoid differences in interpretation due to translation. Further, we cannot see the relevance of duplicating rulebooks or any other information - maintaining information in more than one language requires resources. We suggest to delete the last part of the sentence saying: "as well as in at least one of the official languages of the Member State where the CCP is established".

Q29: Should a principle of full disclosure to the public of all information necessary to be able to understand whether and how the CCP meets its legal obligations be included in the RTS? If yes, which should be the exceptions of such disclosure requirements? Has the information CCP should

disclose to clearing members been appropriately identified? Should clients, when known by the CCP, receive the same level of information?

Oslo Clearing supports the principle of disclosure, however in order to avoid imposing more burdens on the CCP, we suggest that such disclosure is co-ordinated with the Self Assessment, in accordance with the CPSS-IOSCO principles.

We believe that The Self Assessment document should provide more than appropriate information on the CCP to members, clients and to the general public, if this is the purpose of the disclosure requirement. Further, we would point to the fact that in Norway, annual reports and accounts are easily accessible to the public, and with reference to our answer to question 28, we believe that more than sufficient information will be available, so as to meet the intention behind question 29.

The process of authorising and subsequently supervising the CCP's would also uncover whether the CCP meets its legal obligations, thus a positive assessment from the competent authorities, publicly available following the regular supervisions, should suffice

For any clearing member or party that needs to ensure that the CCP meets it's legal obligations, there is always an opportunity to request a Due Diligence on the CCP.

Record keeping (art. 27)

Q30: What are your views on the possible records CCPs might be required to maintain?

Requirements are extensive, we would encourage ESMA to review the requirements in order to define what is pertinent information. Please also refer to the EACH answer to question 31.

Q31: What are your view on the modality for maintaining and making available the above records? How does the modality of maintaining and making available the records impact the costs of record keeping?

Our understanding is that the requirements for record keeping are forward looking, i.e. that it is from the point in time the CCP has been authorised under EMIR, or the point of time the clearing obligation for a class of OTC derivatives come in to effect, that the requirement will apply.

The extensive data and level of granularity required by ESMA may not be available before the full implementation of EMIR.

Further, the data storage period (number of years of keeping historical data) and the granularity of data drives costs (proportionally), implying that the more extensive the requirements are, the more costly clearing service .

The choice of the storage medium will also affect the costs, thus depending on the ease of access, i.e. could data storage be on tape, rather than on disk, since the first option is less expensive.

EACH Comment: Art 23-24/27 Q24-31 Recognition, Organizational requirements / Record keeping

- On Question 31 we would like to emphasize that the modality of maintaining and making the records available is a huge cost driver for the record keeping and should therefore be avoided.

Business continuity (Art. 32)

Q32: What are your views on the possible requirements for the business continuity and disaster recovery plan and in particular on the requirements for the secondary site? Would it be appropriate to mandate the establishment of a third processing site, at least when the conditions described above

apply? What are the potential costs and time necessary for the establishment of a third processing site and for immediate access to a secondary business site?

Oslo Clearing supports the answer provided by EACH, below.

EACH Comment: Art 32 Q32-33 Business continuity

- Geographical independent business continuity planning can be a huge cost driver and only be applied, where appropriate. The principles set out in EMIR level 2 should be completely consistent with CPSS-IOSCO principles for FMIs. A number of proposals set out in the discussion paper are more demanding than the latest version of the CPSS-IOSCO principles.

Q34: Are the criteria outlined above appropriate to ensure that the adequate percentage above 99 per cent is applied in CCP's margin models? Should a criteria based approach be complemented by an approach based on fixed percentages? If so, which percentages should be mandated and for which instruments?

Oslo Clearing has no issue with a minimum confidence level defined at 99 pct. for margining.

Oslo Clearing is concerned about prescriptive requirements set by ESMA that potentially could act counter to sound risk management principles. The CCP is the closest to consider the risk level in the markets that it clears, and the CCP sets margin requirements in accordance. Prescription in the form of percentages or parameters defined by ESMA implies in reality that ESMA is overtaking the responsibility for margin models for all CCP's across the EEA.

From a CCP standpoint, leaving ESMA to decide on margin levels is fine, as long as ESMA also accepts any responsibility for any misspecification of risk models and setting parameters, which are conducive to inadequate levels of collateral to handle actual situations of default, or situations of financial distress.

Should ESMA refrain from accepting such responsibility, then ESMA should leave to the CCP's to define adequate margin levels, and thus in our view the ESMA approach should be principles- or criteria-based.

Please also refer to the answers provided by EACH, which Oslo Clearing supports.

EACH Comment: Art. 39-Q34-37 Margins

- Most of the EACH Members biggest concern is that the combination of margin levels (therefore confidence level) and default fund size should be a decision of each CCP and their Clearing Members, adapting to the type of products.

- Nevertheless it should also be stated that the 99% threshold is fully accepted. EACH would again like to emphasize the need for consistent regulations. For example CPSS-IOSCO proposes a confidence level of 99%. Additional requirements above 99% will disincentives the use of European CCPs.

- In general the cost of margins will rise significantly under the new clearing obligation and may hinder the economic growth. It should be avoided, that the cost of collateral and corresponding liquidity for end users will explode by such a restrictive margin regime. This effect is not mentioned in the Pro/Con description under Para 93

- In general for requirements above 99% the CCPs other lines of defense should be taken into account.

- Considering the validation regime established in articles 39 and 46, a too prescriptive approach seems unnecessary.

- Q34: The confidence level means the number of days (expressed as a percentage) initial margins would cover the expected losses upon default.

    - The calculation of the confidence level is not standardized. Methods differ structurally. E.g. results calculated by an out-of-the-sample back testing method cannot be compared with results achieved by an in-sample historical look back view.

    - To consider other criteria such as liquidity risk may result in a longer close-out period or such as non-linearity may result in not applying a normal distribution. Both cases may not necessarily lead to an increase of the confidence level.

- It should be considered that lowering the risk of loss sharing / using the default fund may increase systemic risk. Clearing members will be less strict in supervising CCPs´ risk management due to higher margins available from the defaulting clearing member. Even for surviving clearing members there will be fewer incentives to participate in a liquidation process due to reduced exposure to the default fund.

- Q36: We consider the liquidation period as the time since the last collection of margins to the close-out or hedge of the position. We don't think a table with the exact number of days should be part of the RTS.

Q35: Taking into account both the avoidance of pro-cyclicality effects and the need to ensure a balance distribution of the financial resources at the CCP disposal, what it is in your view the preferred option for the calculation of the look-back period.

Oslo Clearing has a pragmatic approach to pro-cyclicality currently, whereby margin levels shall as a guiding principle not change by more than 1 notch in our margin scale, however, statistical evidence, market factors may indicate a need to perform substantial adjustments to individual margin rates. Such decisions shall be supported by a qualified assessment.

Else, pro-cyclicality is a difficult issue, f.ex. in a situation of financial turmoil, the CCP' s will typically want to increase their collateral base, so as to enhance their ability to withstand one or several defaults. Increasing margin rates due to increasing market volatility could in turn expose clearing members to additional financial stress. Thus, the dilemma of the CCP is between guarding its own interest and that of not increasing financial stress in the market.

We do not believe that a CCP should margin in accordance with extreme levels of volatility on a permanent basis, since this would imply that clearing members should hold amounts of collateral well in excess of 'normal ' risk levels at all times, i.e. increasing the cost of clearing.

Please also refer to our answer to question 34. With respect to the look-back period, we believe this also should be the competence of the CCP.

Q36: Is in your view the approach described above for the calculation of the liquidation period the appropriate one? Should a table with the exact number of days be included in the technical standards? Should other criteria for determining the liquidation period be considered?

Please refer to our answer to question 34. We believe that deciding on the liquidation period should be the competence of the CCP.

However, as a general comment, recent liquidity observations in a market is a better indicator than historical liquidity, although a CCP should take into consideration that when it must liquidate a position or portfolio, we must assume that markets no longer will display the same degree of liquidity.

Q37: Is pro-cyclicality duly taken into account in the definition of the margin requirements?

Please refer to our answer in question 35. Our margin methodology implies that pro-cyclicality is taken care of.

Default fund (art. 40)

Q38: What is your view of the elements to be included in the framework for the definition of extreme but plausible market conditions?

Ideally both historical and theoretical scenarios should be considered when defining 'extreme, but plausible' scenarios. Extreme scenarios are challenging, since defining extreme outcomes for all risk factors may lead to an infinite number of scenarios. However, extreme scenarios should have the aptitude to capture recent (years') historical events. Historical events may serve as a reference, but references to events far back in time may not be relevant due to altered framework (regulatory) and changes to market practices. Thus, the re-occurence of such event(s) would no longer plausible.

Oslo Clearing applies a confidence interval of approximately 99,99 pct. when setting the scenarios for our stress-test on our exposures towards clearing members. We would like to draw your attention to the EACH best practice for stress-testing that has been elaborated in conjunction with the new CPSS-IOSCO standards.

Liquidity controls (art. 41a)

Q39: Do you believe that the elements outlined above would rightly outline the framework for managing CCPs' liquidity risk?

Yes.

Oslo Clearing would draw the attention to the fact that CCP's are being considered to be systemically important, thus access to central banks, i.e. being able to deposit excess liquidity (own funds, but also cash collateral received from members), and also having access to central bank credit facilities, should be a prerogative given to the CCP's.

Q40: Do you consider that the liquid financial resources have been rightly identified? Should ESMA consider other type of assets, such as time deposits or money market funds? If so, please provide evidences of their liquidity and minimum market and credit risk.

Should time deposits be readily available (possibility to withdraw the funds on short notice, provided a break-up fee) or money market funds that can be accessed on short notice, then these funds should be counted.

Q41: Should the CCP maintain a minimum amount of liquid assets in cash? If so, how this minimum should be calculated?

The CCP must be able to decide what is an adequate cash balance, in order to meet the current liquidity requirements. The CCP must take into consideration that holding excess cash balances represents a cost (lower return), but also at the same time a credit risk, since potentially large amounts will be held with one or several credit institutions, cf. our answer to question 39.

The CCP shall be able to demonstrate that its cash balances are adequate, i.e. we see no need for prescription, and the CCP should be able to measure in- and outflows of cash in connection with the planned settlements, but also related to return of margins, or calls from interoperating CCPs.

The CCP should be able to perform planned settlements, subject to the failure of the largest settlement transaction (which may not imply that a member defaults on all its obligations towards a CCP). A CCP should have in its rulebook the possibility to defer settlement to the non-defaulting parties, with a pre-defined period for performing settlement, and sufficient liquidity to make advances for parts of such fails.

Default waterfall (Art. 42)

Q42: What is your preferred option for the determination of the quantum of dedicated own resources of CCPs in the default waterfall? What is the appropriate percentage for the chosen option? Should in option a, the margins or the default fund have a different weight, if so how? Should different criteria or a combination of the above criteria be considered?

Oslo Clearing supports the views of EACH with respect to the default waterfall.

We, would further want to draw your attention to the fact that the default fund and the member contributions to the default fund are less dynamic than margin requirements, due to:

- periodical calculations of its total size and the individual member contributions
- defined levels of minimum contribution

These features are captured in EMIR art. 40.1 and 40.2. A method to calculate the size of the default fund, the individual contributions, but most importantly the CCP's 'skin-in-the-game', which is dependent on volatile components as suggested by one of the alternatives proposed by ESMA, would require the CCP's to have swift and uncommitted access to equity capital. There is little realism in such an alternative, provided the corporate procedures needed to raise equity capital.

Oslo Clearing is in favour of a method to establish the 'skin-in-the-game' that avoids short term volatility.

EACH Comment: Art 42 Q42-43 Default Waterfall

- Regarding the options presented by ESMA we strongly oppose a fixed percentage linked to margins as this can become quite dangerous. The requirement may bounce around given the volatility of margins. In this way it can cause a material risk to the CCPs financial strength which would especially be important after a default when the amount could be a loss to the CCPs capital.
- While we would urge ESMA not to link the skin in the game to the margins there are some arguments to link it to the size of the clearing fund or the CCP capital. However it should be considered which incentives or better disincentives are set by such a linkage to raise the clearing fund or the CCP capital.
- Q43: yearly calculation with an adaption after a further year would give sufficient time to determine the skin in the game. This would also fit with the requirements outlined in Q67.

Q43: What should be the appropriate frequency of calculation and adaptation of the skin in the game?

The recalculation of the size of the default fund and individual contributions, thus also the CCP's 'skin-in-the-game' could be done quarterly, possibly monthly.

Collateral requirements (art. 43)

Q44: Do you consider that financial instruments which are highly liquid have been rightly identified? Should ESMA consider other elements in defining highly liquid collateral in respect of cash of financial instruments? Do you consider that the bank guarantees or gold which is highly liquid has been rightly identified? Should ESMA consider other elements in defining highly liquid collateral in respect of bank guarantees or gold?

Oslo Clearing supports the comments from EACH.

A CCP should be able to set stricter requirements on collateral than those defined by ESMA if required, thus not being forced to accept the entire universe of eligible collateral proposed by ESMA.

EACH Comment: Art 43 Q44-50 Collateral Requirements

- There are several details to be clarified/adjusted, which in the current wording mean unnecessary pinpricks to CCPs collateral management capabilities (e.g. Q44 Para 120: cash deposited with a CCP with a banking licence should also count as collateral, Bonds issued by clearing members that are guaranteed by a member state should be acceptable as collateral)
- EACH wonders why CCPs in general should not be able to accept collateral, which is accepted by central banks. However CCPs should not be forced to accept any collateral, which is accepted by central banks.

'Highly liquid' should be assessed as a function of the available 'stock' of the underlying instrument and trade volume. There is still a risk that a CCP could end up having a concentrated collateral position in one series or one underlying financial instrument. This would pose problem for the liquidation of the collateral.

The presence of market makers with requirements to quote certain volumes within certain spreads has a positive impact on liquidity.

There is no definite answer to exactly what type of instruments that can be deemed as being highly liquid, and having little or no credit and market risk. Even government bonds may fall in to the category of non-desired collateral.

The criteria for use of collateral should focus on the CCPs ability to use risk based methods in setting adequate haircuts for different types of instruments, series of interest rate instruments, equity market instruments, etc., so as to receive as a minimum the expected collateral value under liquidation of the assets.

Q45: In respect of the proposed criteria regarding a CCP not accepting as collateral financial instruments issued by the clearing member seeking to lodge those financial instruments, is it appropriate to accept covered bonds as collateral issued by the clearing member?

Yes, as long as it is not the clearing member itself that provides this collateral. The CCP must only ensure that this collateral is counted in the exposure measurement towards the actual clearing member.

Q46: Do you consider that the proposed criteria regarding the currency of cash, financial instruments or bank guarantees accepted by a CCP have been rightly identified in the context of defining highly liquid collateral? Should ESMA consider other elements in defining the currency of cash, financial instruments or bank guarantees accepted by a CCP as collateral? Please justify your answer.

Please refer to our answer to question 44.

Further, we do not see the reasoning behind a requirement to accept cash denominated only in the currency of the Member State where the CCP is established, nor that it should be tied to the currency denomination of the products cleared.

A CCP should offer to its clearing members, which may be located in other Member States, using other currencies, the choice to elect their preferred currency for cash collateral. With reference to question 44, the CCP needs only to define an appropriate haircut.

Q47: Do you consider that the elements outlined above would rightly outline the framework for determining haircuts? Should ESMA consider other elements?

Please refer to our answers to questions 35, 44 and 46.

Q48: Do you believe that the elements outlined above would rightly outline the framework for assessing the adequacy of its haircuts? Should ESMA consider other elements?

Please refer to our answers to questions 35, 44 and 46.

Oslo Clearing would prefer ESMA to focus on principles and adopt a more criteria based approach, leaving it to the CCP's to decide the methodology for setting haircuts, and accordingly at a correct risk level, please also refer to our answer to question 34.

Q49: Do you consider that the elements outlined above would rightly outline the framework for determining concentration limits? Should ESMA consider other elements?

A CCP should, based on its risk methodologies decide on concentration limits. In our experience, there is no technique or algorithm available to identify concentrations, what may be a concentrated position for one underlying instrument (ISIN), may not be the case for another, which would potentially penalise the use of a certain collateral (limits being too severe) or be to lax, creating undesired exposures of collateral within the CCP.

A CCP should either apply haircuts and margin rates that vary in line with the size of the clearing house's exposure so that greater exposures relative to liquidity warrant higher margin rates / haircuts (as the closing out period increases) or, alternatively, haircuts / margin rates should be set assuming a certain level of exposures, and when exposures rise above the level assumed haircuts / margin rates are increased accordingly. This method is applied by Oslo Clearing. This principle should apply to both cleared transactions as well as collateral accepted.

A correct valuation of the collateral (market value less haircut) is equally important as correct margining of cleared transactions, and volumes (of collateral and cleared transactions) vis-à-vis liquidity of the instrument in question is an important factor in determining the correct margin requirement / collateral value. Concentration limits on collateral, either as an absolute amount per instrument / class / counterparty, or as a percentage of total held collateral may be appropriate, but are handled more adequately within the CCP. Large concentrations should impact the results of the CCPs stress testing, as stress testing ought to assume the default of a counterparty that the CCP is heavily exposed to.

Q50: Should a CCP require that a minimum percentage of collateral received from a clearing member is provided in the form of cash? If yes, what factors should ESMA take into account in defining that minimum percentage? What would be the potential costs of that requirement?

A CP may define such a minimum percentage, depending on what it perceives being the required level of liquidity, which should be available to manage a default situation. This may diverge from CCP to CCP, basically, it should be up to the CCP to decide.

Investment policy (art. 44)

Q51: Do you consider that financial instruments and cash equivalent financial instruments which are highly liquid with minimal market and credit risk have been rightly identified? Should ESMA consider other elements in defining highly liquid financial instruments with minimal market and credit risk? What should be the timeframe for the maximum average duration of debt instrument investments?

The criteria set by ESMA are sensible, please also refer to the comment made by EACH.

EACH Comment: Art 44 Q51-56 Investment Policy

- In principle, it makes sense to limit unsecured exposures. However, as far as the CCPs balances are influenced by securities settlements and margin inflows, which cannot be fully controlled at all times, the amounts remaining in correspondent bank accounts may exceed any limits.

Q52: Do you think there should be limits on the amount of cash placed on an unsecured basis?

The concept 'unsecured basis' is not clearly defined, which makes it difficult to provide an answer. Please also refer to the answer from EACH to this question.

Q53: Do you consider that CCP should be allowed to invest in derivatives for hedging purposes? If so, under which conditions and limitations.

A CCP should not be refrained from using derivatives, f.ex. to secure FX or interest rate exposures. A CCP operating in a multi-FX environment would probably seek to minimise it's FX risks. Prohibiting use of FX derivatives would thus act to the detriment of the CCP.

Further, there should be no questioning the option for a CCP to use derivatives in order to manage default situations.

Q54: Do you consider that the proposed criteria regarding the currency of financial instruments in which a CCP invests has been rightly identified in the context of defining highly liquid financial instruments with minimal market and credit risk? Should ESMA consider other elements in defining the currency of highly liquid financial instruments with minimal market and credit risk? Please justify your answer.

Oslo Clearing does not have any particular issues with the criteria.

Q55: Do you consider that the elements outlined above would rightly outline the framework for determining the highly secured arrangements in respect of which financial instruments lodged by

clearing members should be deposited? Should ESMA consider other elements? Please justify your answer.

Oslo Clearing does not have any particular issues with the criteria.

Q56: Do you consider that the elements outlined above would rightly outline the appropriate framework for determining concentration limits? Should ESMA consider other elements? Please justify your answer.

Please refer to our answer to question 49, the same applies here.

Review of models, stress testing and back testing (Art. 46)

Q57: What are your views on the definitions of back and stress testing?

Oslo Clearing does not see the relevance of involvement of clearing members or other parties in the stress-tests, nor do we see the rationale for disclosure. The stress-tests are aimed at determining the level of financial resources required for the CCP to handle default situations subject to the conditions set by EMIR.

However, we have no issues disclosing the main principles for our stress-testing. We advise against involving members and other parties in any of the elements from the design to the output relative to stress-test. Such involvement, in our opinion, entails the risk of those parties external to the CCP to potentially influence the outcomes, i.e. creating conflicts of interest.

ESMA should carefully reconsider the contentious issues of involving other parties and the requirement to disclose information on stress-tests.

We would also refer to the EACH comments on stress-testing and back-testing.

EACH Comment: Art 46 Q57-68 Review of models, stress testing and back testing

- EACH would like to mention that the transparency of the models must be limited. Any optimization of clearing members risk management based on the knowledge of CCPs models should be avoided.
- Q66: The simulation of the default procedure with clearing members should be limited where it is appropriate.

Q58: What are your views on the possible requirements for a CCP's validation process?

Please refer to our answer to question 34. Oslo Clearing is satisfied by a validation process that requires a third party to perform an assessment prior to application.

Q59: What are your views on the possible back testing requirements?

Oslo Clearing has no particular issues with the requirements.

Q60: Would it be appropriate to mandate the disclosure of back testing results and analysis to clients if they request to see such information?

No.

We believe that internal processes (submitting back-test results to the Risk Committee), but also supervision, and in particular if any assessment is made public, should suffice to provide members, and also other interested parties with sufficient comfort about the margining model of the CCP.

ESMA should more closely consider whether submitting back-test results to the Risk Committee raises any conflict of interest.

Q61: Should the time horizons for back tests specified under 144(e) be more granular? If so, what should the minimum time horizon be? Should this be different for different classes of financial instruments?

No.

The definition of the granularity should be left to the CCP, or those conducting an independent review. Oslo Clearing relies on likelihood ratio test statistic by Kupiec (1995) to verify the adequacy of the margins. To validate the model some 1.000 observations are required for a 99 pct. confidence level. Margin models of other CCPs may be set at different confidence levels, requiring a different amount of data, and further, depending on the back-test methodology applied other CCPs may be subject to other data requirements.

Risk factors (stress-tests)

Q62: What are your views on the possible stress testing requirements?

Oslo Clearing has no particular issues with the requirements.

Q63: Would it be appropriate to mandate the disclosure of stress testing results and analysis to clients if they request to see such information?

The definition of client is missing in this context, and may lead to several interpretations. Is the 'client' supposed to be a clearing member or a party that uses a clearing member (customer)?

We do not believe that the disclosure of this information is uncontroversial. Disclosure may open for clearing members to interfere with and influence the tests in their favour. Please bear in mind the requirements about the independence of the risk management function and handling conflicts of interest, cf. questions 24 to 26.

Q64: What are your views on the possible requirements for reverse stress tests? And what impact do you think such requirements would have on industry?

The purpose of the reverse stress-test is not clear. Further, there will be an infinite number of potential scenarios that may lead to the exhaustion of the funds of a CCP. A CCP cannot dimension funds for an infinite number of possibilities, should this become a requirement.

Involvement of parties in tests

Q65: Should there be any other parties involved in the definition and review of tests? Please justify your answer and explain the extent to which suggested parties should be involved?

The involvement of the Risk Committee is not uncontroversial – the Risk Committee being composed of representatives of its clearing members, independent members of the board and representatives of the clients, cf. EMIR art. 26. Once more this raises the issue of conflict of interest.

We would prefer that stress-test methodologies are subject to the regular supervision of the CCP, f.ex. that supervision makes use of independent third parties to perform a review of the stress-test methodology.

Q66: Should the testing of default procedures involve a simulation process?

Yes.

Frequencies of tests

Q67: Are the frequencies specified above appropriate? If no, please justify your answer.

Yes.

However, we agree to paragraph 161.c (i) on daily back-testing, only if this is to calculate the actual outcome vs. the margin collateral held, and not to infer from this whether the margin model has failed or not. These results calculated on a daily basis shall serve the purpose of gathering a sufficiently large data set, so that a proper statistical test can be to validate the margin model, cf. our answer to question 61.

Information to be publicly disclosed

Q68: In your view what key information regarding CCP risk management models and assumptions adopted to perform stress tests should be publicly disclosed?

Oslo Clearing would stay at a relatively aggregated level with respect to disclosure. One major challenge is that the more details are published, the more resources must be applied to continuously keep publicly available information up-to-date, cf. our answer to question 28.

Trade Repositories

Reporting obligation (art. 6/7)

Q69: What is your view on the need to ensure consistency between different transaction reporting mechanisms and the best ways to address it, having in mind any specific items to be reported where particular challenges could be anticipated?

The reporting obligation under EMIR to TR's should be co-ordinated with existing of reporting mechanism, so as to avoid possible duplication, but more important ensure efficiency in reporting.

Q70: Are the possible fields included in the attached table, under Parties to the Contract, sufficient to accurately identify counterparties for the purposes listed above? What other fields or formats could be considered?

The required data, as displayed in annex I is comprehensive. We would ask ESMA to closely consider what data are needed, so that the reporting burden can be reduced.

Beneficiaries

Q71: How should beneficiaries be identified for the purpose of reporting to a TR, notably in the case of long chains of beneficiaries?

Please refer to question 70. Further, the CCP will most likely not have data on the beneficiaries, unless the beneficiary is segregated in the accounts of the CCP. Even clearing members forming part of the trade may not be in possession of this information (f.ex. in the capacity of a GCM).

Coding

Q72: What are the main challenges and possible solutions associated to counterparty codes? Do you consider that a better identifier than a client code could be used for the purpose of identifying individuals?

Oslo Clearing has no issue of principles with a unique identifier, however current trading, clearing, and potentially other systems may have to be adapted to such an identifier, which certainly represents a cost.

Q73: What taxonomy and codes should be used for identifying derivatives products when reporting to TRs, particularly as regards commodities or other assets for which ISIN cannot be used? In which circumstances should baskets be flagged as such, or should their composition be identified as well and how? Is there any particular aspect to be considered as regards a possible UPI?

Oslo Clearing has no opinion on taxonomy. The users of the TR's should be the ones deciding on the taxonomy and data structure, so as to meet their need information needs.

Details on the transaction

Q74: How complex would be for counterparties to agree on a trade ID to be communicated to the TR for bilaterally executed transactions? If such a procedure is unfeasible, what would the best solution be to generate the trade ID?

Oslo Clearing has no particular opinion on this.

Q75: Would information about fees incorporated into pricing of trades be feasible to extract, in your view?

No.

Risk mitigation and clearing

Q76: What is your view of the granularity level of the information to be requested under these fields and in particular the format as suggested in the attached table?

With reference to our answer to question 70, the requested data is extensive and will potentially become a burden. We ask ESMA to consider the pertinence of the requested data.

Specific asset classes

Q77: Are the elements in the attached table appropriate in number and scope for each of these classes? Would there be any additional class-specific elements that should be considered, particularly as regards credit, equity and commodity derivatives? As regards format, comments are welcome on the possible codes listed in the table.

Oslo Clearing offers equity and equity derivative clearing. We support the broad categories defined by ESMA, however we assume that options are part of each of the categories defined, implying that options on equity are included in section 2c, for example.

Additional points

Q78: Given that daily mark-to-market valuations are required to be calculated by counterparties under [Article 6/8] of EMIR, how complex would it be to report data on exposures and how could this be made possible, particularly in the case of bilateral trades, and in which implementation timeline? Would the same arguments also apply to the reporting of collateral?

Reporting on mark-to-market increases the reporting obligation, and we question whether this falls within the scope of EMIR. Reporting is feasible, however, it implies standardised formats and interfaces. Developing those for the purpose of reporting represents a cost.

Reporting by third parties

Q79: Do you agree with this proposed approach? What are in your view the main challenges in third party reporting and the best ways to address them?

Subject to having access to the relevant data and having the necessary authorisations in place (PoA), third parties may well perform the reporting function.

Application for registration (art. 52)

Q80: Do you envisage any issues in providing the information/documentation as outlined above? In particular:

a) what would the appropriate timeline over which ESMA should be requesting business plans (e.g. 1, 3, 5 years?)
b) what would the appropriate and prudent length of time for which a TR must have sufficient financial resources enabling it to cover its operating costs (e.g. 6 months / 1 year)?

Oslo Clearing has no opinion on this.

Q81: What is your view on these concerns and the ways proposed to address them? Would there be any other concerns to be addressed under the application for registration and tools that could be used?

Oslo Clearing has no opinion on this.

Transparency and data availability (art. 67)

Q82: What level of aggregation should be considered for data being disclosed to the public?

If being made available to the public, data should be presented in an aggregated form, such that beneficiaries, clearing members or trading strategies are not exposed.

Q83: What should the frequency of public disclosure be (weekly? monthly?); and should it vary depending on the class of derivatives or liquidity impact concerns; if yes, how?

If information is going to be disclosed publicly, we have a preference for the highest frequency, subject to our comment to question 82, but also having due regard to the quality of the data released.