The 305 Omnibus – The Route to a 4% Risk Weighting

Legislative measures promoting the use of CCPs and implementing reforms under the Basel III framework have brought the capital treatment of exposures relating to centrally cleared transactions into sharp focus. Within the EU, the relevant rules are set out in the Capital Requirements Regulation (CRR) which includes new requirements for clearing members and their clients to risk weight their exposures in respect of positions and collateral assets held with a CCP. Under a principal-to-principal model of client clearing the relevant exposures are indirectly held by clients because they access a CCP via a relationship with a clearing member. Hence, there is a need to consider the treatment of the client's positions and assets at both the clearing member level and the CCP level.

The risk weighting afforded to client exposures in respect of cleared transactions under Article 305 CRR will depend upon whether the client's positions and collateral assets at the CCP level are recorded within an individually segregated account (ISA) or an omnibus segregated account (OSA). An ISA client may risk weight those exposures at 2%, provided that the positions and assets related to its transactions benefit from certain porting and/or close-out arrangements and would be bankruptcy remote and bear no losses in the event of an insolvency of its clearing member or another of that clearing member's clients.

For these purposes, the client is able to look through to, and rely upon, its positions and assets at the CCP level (and the segregation arrangements and insolvency protections that they enjoy) as a source of recovery in respect of its trade exposures at the clearing member level. The purest form of such a look through approach would depend upon the client's positions and assets at the CCP level fully matching those at the clearing member level (facilitated, for example, by an arrangement for the clearing member to pass through collateral assets received from its client directly to the CCP). In the event of discrepancies between the two levels, however, an ISA client may still look through to its positions and assets at the CCP level to the extent that their value covers its exposure to the clearing member and, thus, risk weight the relevant portion of that exposure at 2%.

OSA clients benefit from a less favourable 4% risk weighting treatment under Article 305 CRR, due to the potential exposure of their positions and assets to loss mutualisation (at both levels) in the event of a double default of their clearing member and one of its other clients. In addition, OSA clearing arrangements carry a greater propensity for discrepancies between the positions and assets at the clearing member and CCP levels (not least due to the effects of gross vs net margining). There is, therefore, a greater likelihood that the value of an OSA client's positions and assets at the CCP level will not cover the full value of the trade exposures to its clearing member. In such circumstances, however, a 4% risk weighting will still be available in respect of the covered portion.

Similarly to ISA clients, OSA clients are able to rely upon a look through approach to support a favourable risk weighting treatment under Article 305 CRR. The difference between one client account type and the other in terms of the likely availability of such capital relief is simply a matter of degree.

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