

<b>Notice:</b>	<b>13/2011</b>
<b>Issued:</b>	<b>30 September 2011</b>
<b>Effective date:</b>	<b>1 November 2011</b>
<b>Affected products:</b>	<b>Freight, bunker fuel-oil, iron ore and seafood</b>
<b>Amendments:</b>	<b>Rulebook for Clearing with NOS Clearing ASA Establishment of Freight Default Fund and Seafood Default Fund</b>

---

## **Adjustment in clearing capital of NOS Clearing ASA**

**In preparation for the implementation of regulatory reform in the EU pursuant to the European Market Infrastructure Regulation ("EMIR") and the US Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), NOS Clearing ASA ("NOS") has decided to modify its default waterfall and introduce two mutualised default funds. The new structure is in line with that of most other clearing houses and will have a positive risk impact on NOS' clearing members.**

Once EMIR and Dodd-Frank are enacted and effective, which is expected to be sometime between 2012-2013, EU and US clearing houses will be obliged to introduce a level of mutuality among the clearing members. New mandatory rules on clearing houses' default waterfall - the sequence of funds to be used in case of a default - are also expected.

NOS is already subject to a stringent risk management, credit risk, liquidity risk, operational and other risk regimes that in general exceeds the requirements envisaged per EMIR and Dodd-Frank. In some respects, however, NOS' clearing capital model is different. The adjustment in NOS' counterparty capital described herein is the first step in adapting to the new regulatory landscape. The new structure entails that a part of the clearing members' current *base collateral* will be reclassified as *mutual base collateral* and form a default fund. As already posted collateral will be reclassified, clearing members will generally *not* be required to contribute new funds.

NOS will introduce one default fund for the freight related markets (dry and wet freight, as well as bunker fuel-oil and iron-ore) (the "Freight Default Fund") and one default fund for the seafood market (the "Seafood Default Fund"). The clearing members will be required to make an equal contribution and will bear an equal risk within each of the two markets. Clearing members active in the freight related markets will each contribute USD 150 000 to the Freight Default Fund as mutual base collateral. Clearing members active in the seafood market will each contribute NOK 150 000 to the Seafood Default Fund as mutual base collateral. Each clearing member's joint obligation will be limited to its contribution to the default fund(s), and this capital will only be at risk once the preceding default waterfall resources have been exhausted.

As part of the new default waterfall, NOS will contribute from its own resources a first-loss layer of 10 million USD for the Freight Default Fund and 20 million NOK for the Seafood Default Fund to be utilized before the contributions of non-defaulting members. The size of the default funds will depend on the number of active clearing members. If a default exhausts the layers up to and including the default fund, the remaining risk is backed by NOS own capital.

NOS acts as the guarantor and central counterparty in a multilateral netted market. The guarantee is made possible by collecting margin (collateral) to cover the running exposure in each member's portfolio. The margin serves as the primary line of defense to NOS, as for other clearing houses. The margin is calculated on a continuous basis, and margin calls are submitted daily. The level of the margin (size) is set by the existing market conditions, mainly by volatility and liquidity parameters.

NOS uses a prudent margin level that covers 99, 8% of expected price changes over an expected closing period. Margin can only be used to cover costs linked to closing down the portfolio of the defaulting clearing member. NOS uses frequent back-testing to assure that the margin levels are adequate.

To estimate the exposure to be covered by the readily available financial resources in the default waterfall, NOS performs internationally recommended stress tests. Weekly stress tests calculate the risk in an extreme, but plausible scenario. NOS has covered this risk by a mix of own capital, soft capital insurance policies and bank guarantees. Under the new structure that is the subject of this notice, NOS' first-loss layer and the default fund for

each of the freight and seafood market will exceed the potential exposure measured by prudent stress-tests of all clearing members.

After the financial crisis in 2008, regulators are focusing on how to increase the use of cleared derivatives trading in former OTC markets. An important part of this initiative is standardized requirements for the world's clearing organizations. The market for soft capital insurance previously used by clearing houses no longer exists. Such schemes are also not part of the EMIR regulations. NOS' current soft capital insurance will expire 1 November this year.

The new default fund structure announced in this notice and provided for in the revised NOS rulebook is likely to be updated periodically over the next few years, as international regulators continue to adjust and standardize the regulatory framework, and the insurance sector introduces new efficient policy structures.

NOS new default waterfall from 1st November 2011:

1. Defaulting Member's margin
2. Defaulting Member's Individual Base
3. Defaulting Member's Mutual Base
4. NOS Waterfall contribution
5. Default Fund
6. NOS Equity

## Rulebook:

*New text in italics.*

### 1.3

#### Definitions

<i>"Default Fund"</i>	<i>each of the Freight Default Fund, the Seafood Default Fund and any other Default Fund established by NOS.</i>
<i>"Freight Default Fund"</i>	<i>a default fund established, funded and applied in accordance with Clause 6.3 to cover losses arising from a default by a Clearing Member in respect of a Contract for freight, iron ore and bunker fuel oil products.</i>
<i>"Margin Collateral"</i>	<i>total Collateral posted less the Base Collateral and Mutual Base Collateral.</i>
<i>"Mutual Base Collateral"</i>	<i>a Clearing Member's contribution to a Default Fund, in accordance with Clause 6.3 as a precondition to Clearing.</i>
<i>"NOS Waterfall Contribution"</i>	<i>capital allocated by NOS to be applied prior to the application of Default Fund contributions by non-defaulting Clearing Members in accordance with section 6.3.4.</i>

*“Seafood Default Fund”* a default fund established, funded and applied in accordance with Clause 6.3 to cover losses arising from a default by a Clearing Member in respect of a Contract for seafood products.

## 2.1.5

(k) a Clearing Member must provide Base Collateral *and Mutual Base Collateral* in accordance with Chapter 6

## 6.1.2

(a) its requirement for Base Collateral *and Mutual Base Collateral* in accordance with Clause 6.2 and Clause 6.3

## **6.2 Base Collateral *and Mutual Base Collateral***

### 6.2.3

(a) *A Clearing Member must contribute Mutual Base Collateral to the applicable Default Fund as a precondition to trading in any Contract subject to such Default Fund.*

(b) *The Mutual Base Collateral deposited in a Default Fund by a Clearing Member shall form part of such Default Fund. No Base Collateral or Margin Collateral posted by a Clearing Member shall form part of any Default Fund.*

## **6.3 Default Fund and Default Waterfall**

### 6.3.1

(a) *NOS shall maintain each Default Fund in accordance with this Clause 6.3.*

(b) *NOS may in its absolute discretion establish one or more additional Default Funds in respect of Markets not already covered by an existing Default Fund.*

(c) *The initial amount of the NOS Waterfall Contribution to the Freight Default Fund shall be USD 10 million and to the Seafood Default Fund shall be NOK 20 million. NOS shall determine the initial amount of the NOS Waterfall Contribution in respect of any additional Default Funds by means of a Notice.*

(d) *NOS may, in its absolute discretion, adjust each NOS Waterfall Contribution to a Default Fund from time to time. Such adjustments shall be published by means of a Notice.*

6.3.2 *NOS shall establish a minimum size amount for each Default Fund in a Notice. Each Default Fund shall be of an adequate size to address the relevant risks to which such Default Fund relates.*

### 6.3.3

(a) *The minimum Mutual Base Collateral each Clearing Member must contribute for each Default Fund shall be determined by NOS in its sole discretion and set out in a Notice. NOS may in its sole discretion call for a higher Mutual Base Collateral. A Clearing Member may only use cash in a currency approved by NOS to post the Mutual Base Collateral.*

(b) *A Clearing Member’s Mutual Base Collateral shall be subject to the applicable “Collateral and Settlement Agreement”, whereby NOS shall have a security interest in or title to the funds and these shall be kept as cash deposits in one or several of NOS’ settlement banks.*

6.3.4 *Upon the default of a Clearing Member in a Contract for which there is an applicable Default Fund, the obligations of the defaulting Clearing Member to NOS shall be satisfied from the following sources of funds, with each such source being completely exhausted prior to the application of the subsequent source:*

- (a) *the Margin Collateral and Base Collateral of the defaulting Clearing Member, in accordance with Clauses 7.5 and 7.6;*
- (b) *the Mutual Base Collateral of the defaulting Clearing Member;*
- (c) *the applicable NOS Waterfall Contribution as set out in section 6.3.1(c); and*
- (d) *the Mutual Base Collateral contributed to the applicable Default Fund by each non-defaulting Clearing Member, in direct proportion to the total contributions of all non-defaulting Clearing Members to such Default Fund.*

*Subject to the following sentence, any excess amount remaining in the defaulting Clearing Member's Collateral and Settlement Account or Non-Cash Collateral, including accounts for FX Contracts, left after the application of the funds set out in (a) and (b) above shall be transferred to the defaulting Clearing Member. If NOS has called upon a Letter of Credit, such Letter shall be released and the Bank issuing such Letter shall be paid before any excess amount shall be paid to the Clearing Member.*

*Other than those amounts of Collateral expressly permitted by this section 6.3.4, NOS may not use other Collateral deposited by non-defaulting Clearing Members to cover the losses resulting from the default of a Clearing Member.*

6.3.5 *If NOS makes any recovery of losses incurred in connection with the application of the default waterfall in section 6.3.4 (other than losses incurred by the Defaulter), a proportional part of any such recovered amount shall be allocated to the non-defaulting Clearing Members.*

6.3.6 *Clearing Members having posted Base Collateral in excess of the amount set out in accordance with section 6.3.3 before 1 November 2011 shall not be obliged to post additional Mutual Base Collateral, unless otherwise determined by NOS in its sole discretion. If no additional Mutual Base Collateral is posted, the appropriate amount of the Clearing Members' Base Collateral shall be reclassified as Mutual Base Collateral with the remaining amount being Base Collateral. Clearing Members shall be informed in writing of such re-classification.*

## **6.4 Margin Requirements**

## **6.5 Accepted Collateral**

6.5.2 Any excess Collateral after coverage of the Margin Requirement, Base Collateral, *Mutual Base Collateral* and aggregate settlement amounts, may be released by NOS to a Clearing Member upon a written request in the form set out in Annex 3B to Appendix 3 or Annex 10B to Appendix 10. NOS may refuse such release in its sole discretion in and may set-off any other due claims against the Clearing Member against the balance in any Clearing Account of the Clearing Member, subject to Clause 5.2.8.

6.5.3 Clearing Members with several Margining Accounts may use excess Collateral (*calculated in accordance with section 6.5.2*) from one Margining Account to cover Margin Requirements on other Margining Accounts, subject to Clause 5.2.2. If the excess Collateral to be posted to a Margin Account is denominated in a different currency from the base currency of that Margin Account or is a Non-Cash Collateral the excess Collateral will be converted into the same currency as such base currency. NOS will, in its sole discretion, determine the exchange rate for such currency conversions as it considers prudent. NOS will also, in its sole discretion, determine whether and on which terms Non-Cash Collateral may be included in such conversion.

**6.6**

***Extraordinary and intra day margin calls***

7.1.2

(b) any failure to post, or overdue posting of, Collateral for a Margin Requirement or Base Collateral or *Mutual Base Collateral*.

7.6.2

*[Moved to 6.3.4]*

---

For any questions, please do not hesitate to contact NOS Clearing ASA:

Erik Flingtorp  
Senior Vice President  
Tel: +47 23 25 93 04  
E-mail: [fli@nosclearing.com](mailto:fli@nosclearing.com)

Hanne B. Johansson  
Vice President  
Tel: +47 23 25 93 20  
E-mail: [hb@nosclearing.no](mailto:hb@nosclearing.no)