



14 March 2022

Mr. Christopher J. Kirkpatrick
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: ICE Clear Europe Self-Certification Pursuant to Commission Rule 40.6 – CDS
Clearing Stress Testing Policy; CDS Clearing Back-Testing Policy

Dear Mr. Kirkpatrick:

ICE Clear Europe Limited (“ICE Clear Europe” or the “Clearing House”), a registered derivatives clearing organization under the Commodity Exchange Act, as amended (the “Act”), hereby submits to the Commodity Futures Trading Commission (the “Commission”), pursuant to Commission Rule 40.6 for self-certification, amendments to its CDS Clearing Stress Testing Policy (“CDS Stress-Testing Policy”) and CDS Clearing Back-Testing Policy (“CDS Back-Testing Policy”), discussed herein.¹ The amendments will become effective on the first business day following the tenth business day after submission, or such later date as ICE Clear Europe may determine.

Concise Explanation and Analysis

ICE Clear Europe is amending its CDS Back-Testing Policy and its CDS Stress-Testing Policy to describe more fully certain existing Clearing House practices.

CDS Back-Testing Policy

¹ Capitalized terms used but not defined herein have the meanings specified in the ICE Clear Europe Clearing Rules and the CDS Clearing Stress Testing Policy and the CDS Clearing Back-Testing Policy (as applicable).

The amendments to the CDS Back-Testing Policy generally clarify the types of back-testing the Clearing House performs of its CDS risk models. The amendments also make minor terminology updates to conform uses of defined terms, make typographical corrections throughout the document, and add and/or update (as applicable) section names and numbering to improve organization and readability.

The general discussion of the Clearing House's Back-testing approach has been amended to add a new paragraph which specifies that the Clearing House conducts several types of back-tests described in the CDS Back-Testing Policy and that the Clearing House adopts all the available reliable and validated data for each back-test in order to assess the model performance over a long period in which stressed market conditions and idiosyncratic events are likely to have occurred.

A new section has been added to describe the use of overlapping and non-overlapping data in the back-testing of the CDS risk model performed by the Clearing House. The section states explicitly that using non-overlapping back-testing for static portfolios is the preferred approach because the CDS risk model is designed to cover a multi-days risk horizon, but that the lack of sufficiently long data sets may limit the use of the approach. Overlapping back-testing is used in order for the Clearing House to have a statistically significant sample, but the count of exceedances is artificially duplicated. The amendments also discuss the ways the Clearing House addresses the problem of time dependent observations.

The discussion of the implementation of the Basel Traffic Light System (BTLS) has been updated to state explicitly that one of the main assumptions of BTLS is that excessive losses are time independent. The amendments describe how, because multi-horizon overlapping back-testing is time dependent, the problem will be addressed by correcting the number of consecutive exceedances within the risk time horizon.

The discussion of Multi-horizon back testing has been clarified that the observed loss is calculated as the minimum NAV change over 5 days for house accounts. Further clarificatory updates have been made include specifying that shortfall is also known as "back-test exceedances" and that unrealized loss is also known as "worst N-days P&L". These updates have been made throughout the CDS Back-Testing Policy in order to be more descriptive and improve readability. The amendments further reflect that the Clearing House's use of the worst N-days P&L may lead to multiple consecutive back-test exceedances following one large market move in the overlapping back-testing approach.

The discussion of detailed daily back-testing results has been updated to include further explanations of the information presented in Table 2 (Example of the minimum 5-day P/L detail for daily back-testing). Specifically, the amendments provide that the last two examples in Table 2 shows the worst N-days P/L could be the 4-days P/L or 3-days P/L.

The section relating to back-testing the production model with Clearing Members accounts have been amended to clarify that a minimum of one year of observations is required to define the statistical significance of back-testing results.

Provisions relating to back-testing the production model with Special Strategy portfolios have been updated to describe that the set of portfolios tested include strategies like Index arbitrage portfolios with long Index and short Single Names constituent of the current Index. The strategies refer to the main Indices where the Clearing House clears part of the underlying Single Names. Additionally, the amendments provide that back-test results at the 99.5% quantile will be reviewed on at least a monthly basis, and that back-test results at the 99.75% quantile will be reviewed on an ad-hoc basis, when there is a large market move. A table showing portfolio reconstruction for special strategy back-testing has been removed as unnecessary detail now covered in the more general description of the special strategies.

A new section addressing stylized portfolios back-testing has been added and provides that the Clearing Risk Department will perform back-testing on a series of stylized portfolios when a new risk factor is introduced for clearing. Such stylized portfolios aim at replicating certain trading strategies in order to make sure that the risk related to the newly introduced risk factors can be managed through the current CDS risk model. Stylized portfolios back-testing may be carried out more frequently on the risk factors that the largest open interest at the Clearing House in order to provide further assurance regarding the CDS risk model performance. The changes reflect current back-testing practice, and are intended to more clearly document such practices in the Back-Testing Policy.

The provisions relating to univariate back-testing have been updated to provide that back-testing results at 99.5% quantile will be reviewed on at least a monthly basis by the Clearing Risk Department and reported to the Model Oversight Committee on a monthly basis, which reflects current practice. Back-testing results at 99.75% quantile will be reviewed on ad-hoc basis, when stress market conditions might cause breaches at 99.5% quantile.

CDS Stress-Testing Policy

In the CDS Stress-Testing Policy, the description of the use of Hypothetical Scenarios has been updated to clarify that forward looking credit event scenarios are based on both historically observed and hypothetical extreme but plausible market scenarios. This update is intended to more clearly reflect current stress testing practice.

Compliance with the Act and CFTC Regulations

The amendments to the CDS Back-Testing Policy and CDS Stress-Testing Policy as well as the adoption of the Risk Identification Framework are potentially relevant to the following core principles: (B) Financial Resources, (D) Risk Management, and (O) Governance and the applicable regulations of the Commission thereunder.

- *Financial Resources.* As discussed above, the amendments to the CDS Stress-Testing Policy clarify that construction of certain forward looking stress scenarios is based on hypothetical as well as historical scenarios. As amended, the CDS Stress-Testing Policy will facilitate the ongoing stress-testing of financial resources and effective management of credit exposures to CDS Clearing Members. The amendments will thus help the Clearing House ensure that it maintains adequate financial resources to support its CDS

clearing operations. The amendments are therefore consistent with the requirements of Core Principle B and Commission Rule 39.11.

- *Risk Management.* The amendments to the CDS Back-Testing Policy are generally designed to enhance and clarify the descriptions of back-testing performed on ICE Clear Europe CDS risk models. Although these changes are largely not intended to represent a change in current Clearing House practices, they are intended to more clearly reflect those practices and thereby enhance the ongoing implementation and monitoring of back-testing. In particular, the amendments clarify the use of overlapping and non-overlapping data sets, the back-testing of stylized portfolios when new risk factors are rolled out, assumptions around time independence of exceedances, and the review process for the 99.75% quantile back tests (including the frequency of review and the Clearing House committees responsible for review). The amendment to the CDS Stress-Testing Policy would clarify the use of hypothetical scenarios in constructing forward looking credit event scenarios in stress testing of the CDS risk model. Therefore, the amendments will help ICE Clear Europe ensure that its risk model will effectively measure credit exposures and default risks. The amendments thus enhance the Clearing House's overall risk management, consistent with the requirements of Core Principle D and CFTC Rule 39.13.
- *Governance.* As described herein, references to the roles of certain committees and departments with respect to reviews and approvals throughout the CDS Back-Testing Policy have been updated to reflect existing practice with respect to the roles of groups. As such, the amendments provide additional clarity with respect to Clearing House governance and lines of responsibility consistent with the requirements of Core Principle O and CFTC Rule 39.24.

As set forth herein, the amendments consist of the amendments to the CDS Stress-Testing Policy and the CDS Clearing Back-Testing Policy. ICE Clear Europe has requested confidential treatment with respect to the amendments, which have been submitted concurrently with this self-certification submission.

ICE Clear Europe hereby certifies that the amendments comply with the Act and the Commission's regulations thereunder.

ICE Clear Europe received no substantive opposing views in relation to the proposed amendments.

ICE Clear Europe has posted a notice of pending certification and a copy of this submission on its website concurrent with the filing of this submission.

If you or your staff should have any questions or comments or require further information regarding this submission, please do not hesitate to contact the undersigned at George.milton@theice.com or +44 20 7429 4564.

Very truly yours,

A handwritten signature in blue ink, appearing to read 'G. Milton', with a long horizontal flourish underneath.

George Milton
Head of Regulation & Compliance