



April 23, 2015

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:
Collateral and Haircut Policy

Dear Mr. Kirkpatrick:

ICE Clear Europe Limited (“ICE Clear Europe”), a registered derivatives clearing organization under the Commodity Exchange Act, as amended (the “Act”), hereby submits to the Commodity Futures Trading Commission (the “Commission”), for self-certification pursuant to Commission Rule 40.6, the rule amendments discussed herein. The amendments are to become effective on the business day following the tenth business day after submission, or such later date as ICE Clear Europe may determine.

Concise Explanation and Analysis

The purpose of the proposed changes is to adopt a new Collateral and Haircut Policy (the “Haircut Policy”) applicable to Permitted Cover posted by Clearing Members to meet the Clearing House’s Margin and Guaranty Fund requirements. The Haircut Policy codifies and consolidates certain existing practices of the Clearing House with respect to Permitted Cover. Specifically, the policy is designed (i) to set out overall principles with respect to the assets accepted by the Clearing House as Permitted Cover; (ii) to establish a framework for determining absolute and relative limits, as applicable, on the value of the collateral that may be posted by a Clearing Member as Permitted Cover; (iii) to establish a value-at-risk (“VaR”) based methodology for determining haircuts for all Permitted Cover; (iv) to mitigate wrong-way risk from Permitted Cover; (v) to address sources for pricing Permitted Cover; and (vi) to set out certain related monitoring, reviewing and reporting procedures. The Haircut

Policy applies to Permitted Cover for all product classes.¹ Following implementation of the Haircut Policy, the Clearing House will from time to time adjust the haircuts applicable to Permitted Cover under the methodology set forth in the policy.

The general aims of the Haircut Policy are to ensure that the Clearing House can efficiently liquidate all forms of Permitted Cover, that appropriate prices are used for valuation of Permitted Cover and that appropriate haircuts (including, as applicable, cross-currency haircuts) are used. The Haircut Policy also codifies certain general principles considered by the Clearing House in accepting assets as Permitted Cover, including availability of pricing information, the existence of liquid and active markets for buyers and sellers of those assets, the existence of sufficient price history, the ability to liquidate Permitted Cover without causing a market disruption, compliance with legal and regulatory requirements and sufficient operational and technological framework to handle deposit, liquidation and return of such assets as Permitted Cover. Additional general requirements apply to financial instruments, including prohibitions on acceptance of instruments that have non-“vanilla” features such as embedded options, instruments issued by a Clearing Member or its affiliate, instruments issued by a CCP or by entities that provide critical services to the Clearing House (other than central banks) and certain credit-based limits. The Haircut Policy provides that where market conditions warrant, or where the Clearing House’s sovereign risk model indicates deteriorating credit below a certain threshold, the Clearing House may remove securities from the list of Permitted Cover and/or vary applicable haircuts. The Clearing House will notify Clearing Members and other market participants of such actions by Circular. The Clearing House maintains the current List of Permitted Cover (along with haircut rates, limits and restrictions) on its website, https://www.theice.com/publicdocs/clear_europe/list-of-permitted-covers.pdf.

The Haircut Policy contains a methodology for setting absolute limits on the value of non-cash Permitted Cover that can be posted by a Clearing Member. (The Clearing House does not, however, impose absolute or relative limits on the use of US Treasury securities as Permitted Cover.) Absolute collateral limits apply across a group of affiliated Clearing Members and apply across all product categories cleared by that group. The policy also sets out relative concentration limits for Permitted Cover provided by a Clearing Member. The Clearing House publishes on its website the current absolute and relative limits on government bonds provided as Permitted Cover. For government bonds, the absolute limit generally is calculated pursuant to a formula based on data from the repo market for the relevant government bond, taking into account both the overall size of that market and the percentage of that market consisting of repos with a one day maturity. The policy also specifies relevant sources of repo market data for particular types of government securities and gold market data for gold Permitted Cover. The policy also sets out alternative approaches for determining the limit for certain government bonds, including for UK, Swiss and Canadian government bonds. The policy sets out procedures for monitoring of limits on a daily basis and for remediation of breach of a limit by a Clearing Member.

¹ Although the Haircut Policy generally also applies to Permitted Cover posted with respect to Guaranty Fund requirements, certain additional requirements apply to Guaranty Fund contributions under the Rules and Finance Procedures. Those additional requirements are not proposed to be changed in connection with the Haircut Policy.

The policy also provides for a risk-based reduction in absolute limits for government bonds based on the credit default swap (CDS) spread for the relevant issuer. Once the spread exceeds a specified level for a particular issuer, the absolute limit for Permitted Collateral of that issuer is reduced pursuant to a defined formula. If the spread exceeds a second level, the absolute limit is reduced to 5% of the otherwise applicable original limit. Spread levels are determined using a five-day average to avoid excessive volatility. This reduction is intended to mitigate wrong-way risk from government bond Permitted Cover. The specified parameters will be reviewed on a quarterly basis.

Specific wrong-way risk arising in connection with clearing of Western European sovereign CDS is addressed through a requirement that US dollar denominated collateral be provided for initial margin and that a portion of the CDS Guaranty Fund be US dollar-based (determined based on the ratio between the dollar-denominated and Euro-denominated initial margin requirements for CDS). In addition, where the member's aggregate short position in sovereign CDS with respect to a sovereign exceeds a specified threshold, the Clearing House may decline to accept government bonds of that sovereign or any other sovereign bonds that exhibit certain correlations with such government bonds.

The Haircut Policy also addresses potential wrong-way risk arising from Permitted Cover more generally. The Clearing House monitors collateral on a daily basis. Where the Clearing House considers there to be strong general wrong-way risk between a Clearing Member and the asset it is posting, the Clearing House will ask the member to change the composition of collateral to mitigate that risk.

The Haircut Policy establishes a VaR-based methodology for determining haircuts for Permitted Cover. The Clearing House calculates six different estimations of VaR for each applicable risk factor. Two estimations are based on a historical simulation approach (using a 1,000-business day (approximately 4 year) lookback period), and a one-day or two-day liquidation period assumption. Four estimations are based on a parametric methodology: two using a 1,000-business day lookback period and a one-day or two-day liquidation period assumption, and two using a 60-business day (approximately 3 month) lookback period and a one-day or two-day liquidation period assumption. Each estimation is calculated using a 99.9% confidence interval (applicable to Permitted Cover posted with respect to all product categories). The proposed haircut will be based on the largest VaR of the 6 estimations. Fixed income assets are divided into separate maturity buckets for each issuer, with a separate haircut established for each bucket. The policy specifies relevant price sources that will be used for the calculation of haircuts for each type of Permitted Cover. Haircuts are determined using the bid prices of Permitted Cover assets, in order to account for higher liquidation costs in stressed markets. The model output is rounded up to the nearest 0.25%, in order to limit unnecessary de minimis variation in haircut levels. The applicable haircuts will be reviewed on a monthly basis, or more frequently where the risk management department deems it necessary.

The risk management department may further adjust the haircuts determined under the model as it determines prudent in light of additional qualitative and quantitative factors. These include the Clearing House's credit assessment of the issuer, current

market conditions and volatility, expected future volatility, the liquidity of the underlying market for the asset, including bid/ask spread, wrong way risk considerations, VaR estimates determined for a period of stressed market conditions, and other factors that might affect the liquidity or value of an asset in stressed market conditions. The Clearing House anticipates that such adjustments to the value calculated under the model would be used only in exceptional circumstances and would expect to use such adjustments to increase haircuts in stressed market circumstances.

The Haircut Policy also sets a minimum haircut level of 3%, in order to avoid procyclical variation in haircuts. (The minimum level will be reviewed annually under the Haircut Policy.) In addition, a haircut add-on of up to 1% will be applied during the period until the next monthly review to issuers presenting increased credit risk. The add-on is applied once the issuer's CDS spread exceeds a specified level, and increases in steps of 0.25% up to a maximum of 1% where the CDS spread exceeds higher thresholds. The add-on is generally designed to anticipate potential haircut increases as part of the next monthly review cycle.

The Clearing House also imposes cross-currency haircuts, which address the exchange rate risk faced by the Clearing House where the Permitted Cover is denominated in a different currency from the currency of the applicable margin requirement. Under the Haircut Policy, cross-currency haircuts are determined using the same methodology described above for other haircuts, but are subject to a minimum haircut of 4.5%. Cross-currency haircuts are applied in addition to any applicable haircut for the relevant form of Permitted Cover.

The Haircut Policy also specifies procedures for periodic review of haircuts and monitoring of Permitted Cover.

Compliance with the Act and Commission Regulations

The amendments to the Haircut Policy are potentially relevant to the following core principles: (B) Financial Resources and (D) Risk Management, and the applicable regulations of the Commission thereunder.

- *Financial Resources.* The Haircut Policy codifies and consolidates ICE Clear Europe's procedures and practices concerning the determination of haircuts and certain other limitations applicable to Permitted Cover provided in respect of margin and guaranty fund requirements. These limitations include establishment of general principles for the assets accepted as Permitted Cover, valuation of Permitted Cover, absolute and relative concentration limits on the amount of a particular bond a Clearing Member may provide as Permitted Cover as well as further measures designed to mitigate wrong-way-risk. The policy is designed to ensure that the Clearing House can efficiently liquidate all forms of Permitted Cover, that appropriate prices are used for valuation of Permitted Cover and that appropriate haircuts are used. As such, it facilitates compliance with the financial resources requirements of the Clearing House under Core Principle B and Commission Rule 39.11.

- *Risk Management.* For similar reasons, the Haircut Policy is also consistent with the risk management requirements applicable to the valuation and haircutting of margin under Core Principle D and Commission Rule 39.13. ICE Clear Europe also believes that the Haircut Policy provides a conservative set of haircuts intended to protect the Clearing House from a decline in collateral value or a change in exchange rates in circumstances where it is required to liquidate Permitted Cover following a Clearing Member default. In addition, the policy permits the Clearing House to respond promptly and appropriately to changes in market conditions by modifying haircuts or other limits on Permitted Cover. The policy thus will facilitate the Clearing House's ability to manage the risks with respect to Permitted Cover provided by Clearing Members, consistent with the requirements of Core Principle D and Commission Rule 39.13.

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

ICE Clear Europe has received no substantive opposing views in relation to the proposed rule 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 patrick.davis@theice.com or +44 20 7065 7738, Dee Blake, Director of Regulation, at dee.blake@theice.com or +44 20 7065 7752 or Paul Swann, President & Managing Director, at paul.swann@theice.com or +44 20 7065 7700.

Very truly yours,



Patrick Davis
Head of Legal and Company Secretary