



May 29, 2019

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  
Recovery Rule Amendments

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, the amendments to its Clearing Rules (the “Rules”)<sup>1</sup> discussed herein. The amendments are to 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 Rules relating to Clearing House default management, recovery and wind-down to address the risk of uncovered losses from a Clearing Member default or series of defaults, among other risks. The amendments largely extend certain existing default management, recovery and wind-down rules currently available for the F&O Contract Category to apply to the CDS Contract Category, with certain modifications appropriate to that type of contract.<sup>2</sup> ICE Clear Europe is also making certain other clarifications and improvements to these rules for

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<sup>1</sup> Capitalized terms used but not defined herein have the meanings specified in the Rules.

<sup>2</sup> ICE Clear Europe adopted its rules relating to Clearing House recovery and wind-down for the F&O and FX Contract Categories in 2014 (the “F&O Recovery Rule Amendments”). See ICE Clear Europe CFTC filing dated May 23, 2014, for a discussion of the terms of those rule amendments and the basis for them.

all Contract Categories. ICE Clear Europe is also adopting new default auction procedures for CDS Contracts.

#### I. Summary of Amendments.

The amendments extend certain existing F&O default management, recovery and wind-down tools to the CDS Contract Category. In particular, the amendments for CDS Contracts enhance existing tools and establish new tools and procedures (and an order of priority for using such tools and procedures) to manage a Clearing Member or Sponsored Principal default or series of defaults and return to a matched book. Certain other improvements are being made to the default management procedures for F&O and FX Contracts.<sup>3</sup> The amendments, among other matters:

- (i) Establish default auction procedures for CDS contracts, including:
  - (A) initial default auctions for CDS, to be conducted in accordance with a new defined set of CDS default auction procedures; and
  - (B) if such initial default auctions are not fully successful, conducting a secondary auction of all remaining CDS positions, to be conducted in accordance with a defined set of CDS secondary auction procedures; and
- (ii) in relation to the CDS Contract Category, if a secondary auction is unsuccessful, or, in relation to the F&O Contract Category, if an auction is unsuccessful, permit partial tear-up of positions of non-defaulting Clearing Members and Sponsored Principals corresponding to the defaulter's remaining portfolio; (Rule 915)
- (iii) in connection with the new default management steps described in (i) and (ii) above, eliminate forced allocation for CDS Contracts as a default management tool; (Deletion of former Rule 905(c) and Rule 401(a)(x))
- (iv) in connection with these default management steps, provide the ability to implement reduced gains distributions (a.k.a. variation margin haircutting) for CDS Contracts following exhaustion of other financial resources, for up to five business days; (Rule 914(o))
- (v) extend to the CDS Contract Category the concept of a "Cooling-off Period" (based on that used for F&O Contracts), which would be triggered by certain Clearing Member or Sponsored Principal defaults with respect to CDS Contracts that result in Guaranty Fund depletion. During a Cooling-off Period, the aggregate liability of a CDS Clearing Member for replenishments of the Guaranty Fund and assessments would be capped at "3x" its required Guaranty Fund Contribution for all defaults during that period. Certain conforming amendments would be made to the Cooling-off Periods applicable under the current Rules for F&O Contracts; (Rule 917)

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<sup>3</sup> The default management, recovery and wind-down rules applicable to the F&O Contract Category also apply to the FX Contract Category. Since ICE Clear Europe does not currently clear any contracts in the FX Contract Category, the following discussion, for simplicity, generally does not refer to the FX Contract Category.

(vi) clarify the process under which a CDS Clearing Member or Sponsored Principal may withdraw from the Clearing House during a Cooling-off Period, related procedures for unwinding all positions of such a CDS Clearing Member or Sponsored Principal and capping its continuing liability to ICE Clear Europe and rights of ICE Clear Europe to call for margin from withdrawing CDS Clearing Members; (Rules 917-918)

(vii) clarify the procedures for full clearing service termination, particularly for CDS Contracts, where that is determined to be appropriate by ICE Clear Europe (Rule 916); and

(viii) in connection with the foregoing, eliminate the Continuing CDS Rule Provisions currently applicable to CDS Contracts and CDS Clearing Members as instead, the document called “Clearing Rules” will apply to CDS Clearing Members in the same way as it applies to F&O Clearing Members.<sup>4</sup>

The amendments are described in more detail in the following sections:

## II. Revisions to Default Management Tools and Steps.

Part 9, which specifies ICE Clear Europe’s remedies upon a Clearing Member or Sponsored Principal default, is being revised to implement the additional recovery tools for CDS Contracts discussed herein. The changes replace forced allocation for CDS with default auctions, reduced gains distribution and partial tear up. Changes are also being made to harmonize default management tools across the F&O and CDS Contract Categories and improve overall clarity.

### *A. Overall Structure of Revised Default Management Provisions*

Rule 905 establishes the overall default management tools and procedures available to the Clearing House to terminate and close out contracts of a Defaulter. Rule 905(b) is being revised to contemplate initial CDS default auctions, as discussed below. Paragraph (c), which provided for forced allocation in the context of CDS Contracts, is being eliminated (along with a corresponding provision in Rule 401(a)(x) and related cross-references throughout the Rules). The amendments add a new paragraph (d), addressing default management where the Clearing House does not resolve a default through the use of its standard default management remedies under Rules 905(a)-(c). Rule 905(d)(i) addresses CDS Contracts, and sets out circumstances for the use of reduced gains distribution, secondary CDS auctions, partial tear-up and

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<sup>4</sup> The Continuing CDS Rule Provisions are certain provisions of the Rules as they were in effect prior to the adoption of the F&O Recovery Rule Amendments, and which continued in effect with respect to the CDS Contract Category, as provided in ICE Clear Europe Circular C14/012 of 31 January 2014 and in the definition thereof in the Rules. Specifically, the Continuing CDS Rule Provisions include prior Rules 105(c), 209 and 912 and certain aspects of Rules 910 and 1102 as they relate to the CDS Contract Category and/or CDS Clearing Members. Following adoption of the Rule amendments relating to the CDS Contract Category, the Continuing CDS Rule Provisions will no longer be applicable, ICE Clear Europe will no longer maintain a document called “Continuing CDS Rule Provisions” on its website, and the published Rules (as amended) will fully apply to CDS Clearing Members as well as F&O Clearing Members. As a result, various references to the Continuing CDS Rule Provisions in the Rules are being removed.

certain other remedies not inconsistent with the other provisions of the Rules. Rule 905(d)(ii) addresses F&O Contracts, and set out circumstances for the use of reduced gains distribution, partial tear-up and certain other remedies not inconsistent with the other provisions of the Rules. Certain other provisions of Rule 905 are being renumbered, and certain conforming and clarifying changes are being made.

### *B. Initial CDS Auctions*

As revised, Rule 905(b)(i) provides for ICE Clear Europe to run one or more Initial CDS Auctions for the CDS Contract Category with respect to the remaining portfolio of the Defaulter.

Initial CDS Auctions will be conducted in accordance with Part 1 of a new defined set of Auction Terms for CDS Default Auctions (the “CDS Default Auction Procedures”). Under those procedures, ICE Clear Europe may break the portfolio into one or more lots, each of which would be auctioned separately. CDS Clearing Members would have an obligation to bid for each lot in a minimum amount determined by ICE Clear Europe. A CDS Clearing Member could transfer or outsource its minimum bid requirement to an affiliated CDS Clearing Member, and similarly a CDS Clearing Member could aggregate its own minimum bid requirement with that of its affiliated CDS Clearing Member. A minimum bid requirement will not apply where the bid would be in breach of applicable law or the Rules, such as if a self-referencing CDS Contract would arise from an accepted bid, or where ICE Clear Europe, after written notification that a minimum bid requirement is inappropriate in the current circumstances, reasonably determines that the requirement should not apply.

Customers will be able to bid indirectly through a CDS Clearing Member. In addition, a Customer, including a Sponsored Principal invited by ICE Clear Europe to participate in an Initial CDS Auction, will have the option to bid directly in the auction (a “Direct Participating Customer”), provided that (i) a Clearing Member has confirmed that it will clear any of its resulting transactions; (ii) it makes a minimum deposit of €7.5 million which may generally be applied by ICE Clear Europe in the same manner as CDS Clearing Members’ Guaranty Fund Contributions (e.g., subject to “juniorization” as described below); and (iii) it has entered into an agreement with ICE Clear Europe pursuant to which it agrees to the auction terms and confidentiality requirement as they apply to Direct Participating Customers. If an auction for any lot or lots fails, as determined in accordance with the default auction procedures, ICE Clear Europe will be able to determine to have a subsequent Initial CDS Auction or Auctions.

The auction for each lot will be conducted as a modified Dutch auction. Where there are multiple winning bidders, all would pay or receive the auction clearing price.

Under Rule 908, all available default resources (including pre-funded CDS Guaranty Fund Contributions of CDS Clearing Members, assessment contributions of CDS Clearing Members and ICE Clear Europe contributions to the CDS Guaranty Fund) may be used to pay the cost of an Initial CDS Auction. Guaranty fund and assessment contributions of non-defaulting CDS Clearing Members will be subject to “juniorization” under Rule 908(i) and will be applied using a defined default auction

priority set out in the CDS Default Auction Procedures based on the competitiveness of their bids. A portion of each CDS Clearing Member's Guaranty Fund Contributions will be allocated to the auction cost of each lot. The CDS Guaranty Fund will be further divided into three tranches. The lowest (and first-used) tranche will consist of contributions of CDS Clearing Members that failed to bid in the required amount in the relevant auction. The second, or subordinate, tranche will include contributions of CDS Clearing Members whose bids were less competitive than a defined threshold based on the auction clearing price. The final, or senior, tranche includes contributions of CDS Clearing Members whose bids will be competitive as compared to a second threshold. (For CDS Clearing Members who bid in the band between the two thresholds, their contributions will be allocated between the senior and subordinate tranches based on a formula.) Thus, contributions of CDS Clearing Members who fail to bid will be used before those who bid, and contributions of those who bid uncompetitively will be used before those who bid competitively. A parallel juniorization approach will apply to the use of assessment contributions, and a similar juniorization approach also applies to contributions of Direct Participating Customers. With this design, ICE Clear Europe believes that the CDS Default Auction Procedures would give CDS Clearing Members a strong incentive to bid competitively, with the goal of reaching an efficient auction clearing price that would permit the Clearing House to close out the Defaulter's portfolio within the resources of the Clearing House.

### *C. Additional Default Measures*

New Rule 905(d) addresses the default management tools of the Clearing House where initial Default Auctions are not successful in closing out the positions of the defaulter. Subclause (i) applies to CDS Contracts, and provides that the Clearing House could engage in reduced gains distribution, Secondary CDS Auctions and partial tear-up, among other actions, as discussed below. Subclause (ii), which applies to F&O Contracts, clarifies that the Clearing House may engage in reduced gains distribution or partial tear-up, as discussed below.

### *D. Secondary CDS Auction*

If one or more Initial CDS Auctions are not fully successful in closing out the defaulting CDS Clearing Member's CDS portfolio, ICE Clear Europe would be able to proceed to conduct a Secondary CDS Auction with respect to the Defaulter's remaining portfolio under Rule 905(d)(i)(B) and the CDS Default Auction Procedures. (As discussed below, under Rule 905(d)(i)(A) ICE Clear Europe would be able to in certain circumstances invoke reduced gains distributions in connection with such an auction.)

The Secondary CDS Auction would be conducted pursuant to Part 2 of the CDS Default Auction Procedures. The Secondary CDS Auction would also use a modified Dutch auction format, with all winning bidders paying or receiving the auction clearing price. A Secondary CDS Auction for a lot will be deemed successful if it results in a price for the lot that is within ICE Clear Europe's remaining CDS default resources, which will be allocated to each lot for this purpose based on the initial margin requirements for the lot. The Secondary CDS Auction procedures

contemplate that Customers could bid directly in the Secondary CDS Auction (without need for a minimum deposit, but provided that a CDS Clearing Member has confirmed that it will clear any resulting transactions of the Non-Clearing Member), or could bid through a CDS Clearing Member.

Under Rule 908(i), in the case of a Secondary CDS Auction, ICE Clear Europe would apply all remaining CDS default resources. Guaranty Fund and assessment contributions of non-defaulting CDS Clearing Members, to the extent remaining, would be subject to “juniorization” in a Secondary CDS Auction, similar to that described above for initial default auctions, in accordance with the secondary auction priority set forth in the secondary auction procedures.

If a Secondary CDS Auction is unsuccessful for any lot, ICE Clear Europe would be able to run another Secondary CDS Auction for that lot. ICE Clear Europe could repeat this process as necessary. However, pursuant to Rule 914(o), if ICE Clear Europe invoked reduced gains distributions, the last attempt at a Secondary CDS Auction (if needed) would occur on the last day of the five-business-day reduced gains distribution period. On that last day, the Secondary CDS Auction for each lot would be successful if it results in a price that is within the default resources for such lot. ICE Clear Europe could also determine, for a Secondary CDS Auction on that last day, that an auction for a lot would be partially filled. With respect to any lot that is not successfully auctioned, in whole or in part, ICE Clear Europe could proceed to partial tear-up under Rule 915, as described below.

#### *E. F&O Default Auction*

The amendments also clarify in Rule 908(b)-(d) that where a Default Auction is held in respect of the F&O Contract Category, any applicable juniorization approach (through modifications to Rule 908) may be set out by the Clearing House by Circular. Certain other drafting clarifications, corrections and conforming changes would be made to Rule 908 as well. Rule 908(f) is being amended to provide for notice of relevant default amount calculations to all affected Clearing Members, rather than publication by Circular, to allow ICE Clear Europe greater flexibility with respect to the manner of notice to affected Clearing Members.

#### *F. Partial Tear-Up*

The amendments add partial tear-up as an additional default remedy, for all Contract Categories. If, in relation to the CDS Contract Category, the Secondary CDS Auction, or, in relation to the F&O Contract Categories, the default auction does not result in the close out of all of the Defaulter’s remaining portfolio within the Clearing House’s remaining resources, then ICE Clear Europe would proceed to a partial tear-up with respect to remaining positions under Rule 915. Under Rule 915(a), ICE Clear Europe will be permitted to use partial tear-up, in relation to the CDS Contract Category, only after it has attempted one or more Initial CDS Auctions or Secondary CDS Auctions, and, in relation to the F&O Contract Categories, only after it has attempted a default auction.

Pursuant to Rule 915(b), in a partial tear-up, ICE Clear Europe would terminate positions of non-defaulting Clearing Members and Sponsored Principals that exactly

offset those in the Defaulter's remaining portfolio (i.e., positions in the identical contracts and in the same aggregate notional amount) ("Tear-Up Positions"). ICE Clear Europe would terminate Tear-Up Positions across both the house and customer origin accounts of all non-defaulting Clearing Members and Sponsored Principals that have such positions, on a pro rata basis. Within the customer origin account of a non-defaulting Clearing Member, Tear-Up Positions of customers would be terminated on a pro rata basis. Where ICE Clear Europe has entered into hedging transactions relating to the defaulter's positions that would not themselves be subject to tear-up, ICE Clear Europe could offer to assign or transfer those transactions to Clearing Members with related Tear-Up Positions.

ICE Clear Europe will determine a termination price for all Tear-Up Positions, in accordance with Rule 915(f), for a CDS Contract based on the last established end-of-day mark-to-market settlement price, and for an F&O Contract based on the last established exchange end-of-day settlement price, subject to a specified fallback price procedure. Under Rule 915(c), the date and time as of which Partial Tear-Up will occur will be set out in a Partial Tear-Up Circular published by the Clearing House. For the CDS Contract Category, tear-up occurs contemporaneously with the determination of the termination price at end of day. Because the termination price equals the current mark-to-market or other applicable settlement value as determined pursuant to the applicable exchange or ICE Clear Europe end-of-day settlement price process (and will be satisfied by application of mark-to-market margin posted (or that would have been posted but for reduced gains distribution) under Rule 915(e)), no additional amount would be owed by ICE Clear Europe in connection with the tear-up.

#### *G. Reduced Gains Distributions*

As an additional secondary default management action, ICE Clear Europe is extending a modified version of its variation margin haircutting rules in Rule 914 to the CDS Contract Category. ICE Clear Europe is renaming the prior provisions for margin haircutting, which only applied to the F&O Contract Categories, as "reduced gains distribution." Certain clarifications are being made to the provisions as they apply to F&O Contracts. For example, Rule 914(b) is being revised to clarify that in the case of any Contract Category, ICE Clear Europe will determine at the close of business on each business day in the Loss Distribution Period whether the conditions for reduced gains distributions would be continuing. Clarifications have also been made for all Contract Categories to state explicitly that reduced gains distribution would only apply to variation or mark-to-market margin, and not initial or original margin. Additional changes in Rule 914(i) clarify the obligations of the Clearing House upon termination of reduced gains distribution.

The potential use of reduced gains distribution for CDS Contracts under the revised Rules are narrower in certain respects than for the other Contract Categories, consistent with the use of reduced gains distribution for other swap clearing organizations.<sup>5</sup> For CDS Contracts, reduced gains distribution may be invoked under Rule 914 only where ICE Clear Europe has exhausted its remaining available default

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<sup>5</sup> See, e.g., ICE Clear Credit LLC Rule 808.

resources (including assessment contributions received). In addition, for the CDS Contract Category, pursuant to Rule 914(n), ICE Clear Europe could invoke reduced gains distribution only for up to five consecutive business days. Reduced gains distribution would allow ICE Clear Europe to reduce payment of variation, or mark-to-market, gains that would otherwise be owed to Clearing Members, during which time, in relation to the CDS Contract Category, it would attempt a Secondary CDS Auction or conduct a partial tear-up. Rule 914(a) and 914(n) will specify certain conditions to the commencement of reduced gains distribution for CDS Contracts, including that ICE Clear Europe has exhausted all other available default resources and has determined that reduced gains distribution is appropriate in connection with a Secondary CDS Auction or partial tear-up.

Pursuant to Rule 914(o), for the CDS Contract Category, if ICE Clear Europe conducts a successful Secondary CDS Auction, that day, or if ICE Clear Europe so determines, the preceding business day, would be the last day for reduced gains distribution. If ICE Clear Europe is unable to conduct a successful Secondary CDS Auction by the end of the five business day reduced gains distribution period, ICE Clear Europe would proceed to conduct a partial tear-up under Rule 915 as of the close of business on such fifth business day.

Pursuant to Rule 914(p), if reduced gains distribution applies to CDS Contracts on any day, the net amount owed on such day to each Margin Account of each Contributor that is deemed to be a “cash gainer” in respect of its house or customer origin account (i.e., a Contributor that would otherwise be entitled to receive mark-to-market margin or other payments in respect of such account) would be subject to a percentage haircut, based on the incoming mark-to-market margin from other Clearing Members. Because reduced gains distribution would only be used following exhaustion of other resources, the Clearing House would only use incoming mark-to-market margin payments to pay mark-to-market margin gains. Haircuts are determined independently on each day of reduced gains distribution for CDS Contracts, and are applied separately for each margin account for each Contributor. For each day of reduced gains distribution, ICE Clear Europe would notify Clearing Members and the market more generally of the amount of the haircut and such other matters as ICE Clear Europe considers relevant, through a Circular.

An amendment in Rule 906(a) also clarifies that the calculation of a net sum on default will treat the payment or return of variation margin or mark-to-market margin as having been successfully and fully made even if reduced gains distributions have been applied, and therefore the defaulter will not pay or receive such variation margin or mark-to-market margin in the net sum on default.

#### *H. Removal of Forced Allocation as a Default Management Tool*

Existing Rule 905(c), which allowed ICE Clear Europe to make a forced allocation of positions in the defaulter’s portfolio, is being removed in light of the new default management tools described above.

#### *I. Recoveries from Defaulting Clearing Members*



The amendments to Rule 907 add a new subsection (c), which addresses the Clearing House's authority to seek recoveries from a defaulting Clearing Member on its own behalf and on behalf of Clearing Members, including through setoff or legal process. The rule are also being revised to state ICE Clear Europe's obligations with respect to seeking recoveries from a defaulting Clearing Member where the Guaranty Fund Contributions of non-defaulting Clearing Member have been applied, and provide that in such case ICE Clear Europe will exercise the same degree of care in enforcement and collection of any claims against the defaulter as it exercises with respect to its own assets that are not subject to allocation to Clearing Members and others. Certain contrary provisions of the Rules to the effect that the Clearing House has no obligation to pursue recoveries from defaulters, such as existing Rule 914(m), are being removed.

#### *J. Delay of Outbound Variation Margin*

The amendments extend the provisions of Rule 110(f) to the CDS Contract Category. Rule 110(f) permits the Clearing House to delay making a variation margin or mark-to-market margin payment, solely on an intra-day basis, where a Clearing Member or Sponsored Principal has failed to make a corresponding payment to the Clearing House (including without limitation for technical or operational reasons), and the amount of the failure exceeds the initial or original margin posted by that Clearing Member or Sponsored Principal.

### III. Clarifications of Guaranty Fund Requirements and Uses.

Various clarifications and conforming changes are being made to the provisions of Rule 908, which address contributions to and uses of the Guaranty Fund. Provisions in Rule 909 are also being moved and reorganized, and Rules 910-911 is being removed and reserved. These changes include the following:

- Changes to ICE Clear Europe's ability to modify the order of application of Guaranty Fund Contributions under the Auction Procedures to provide for juniorization based on bidding (Rule 908(i), and conforming cross-references throughout).
- Changes to produce in Rule 909 a single Powers of Assessment rule for all Contract Categories, eliminating inconsistencies across the default rules for different products. Various deletions and insertions are being made to remove duplication between the three Contract Categories. In addition, a certification requirement in connection with the application of claims under any default insurance policies for F&O Contracts is being removed as unnecessary (Rules 909 – 911).
- Rule 909(a) would permit assessments for CDS Contracts to be called in anticipation of any charge against the CDS Guaranty Fund following a default, rather than only after such a charge. This change is consistent with the current treatment of assessments for F&O Contracts.

- Certain changes would be made throughout Part 11 to align the process for return of Guaranty Fund Contributions following termination of Clearing Membership across all Contract Categories, align Guaranty Fund Contribution calculation methodology across Contract Categories and to clarify that separate Guaranty Fund Contribution amounts calculated in respect of Proprietary and Customer positions may be applied across any type of account. A change to Rule 1101(e) is being made to better reflect current practice for the calculation of Guaranty Fund Contributions.

#### IV. Use of Cooling-Off Period.

ICE Clear Europe is modifying the Cooling-off Period concept in Rule 917 in order to apply it to CDS Contracts, to adjust the calculation of the relevant cap on contributions for all Contract Categories, and to reduce the length of the period. Cooling-off Periods could be designated, and would operate, separately in respect of different Contract Categories. A Cooling-off Period is triggered by certain calls for assessments for the relevant Contract Category or by sequential Guaranty Fund depletion in the relevant Contract Category within a specified period. The base length of the Cooling-off Period is being reduced from 30 Business Days to 30 calendar days, consistent with the approach of other clearing organizations,<sup>6</sup> and in order to balance the goals of limited liability and certainty for Clearing Members with the need for the Clearing House to restore normal operations following recovery as quickly as possible. As under the current Rules, a Cooling-off Period could be extended as a result of subsequent defaults during the period.

Rule 917(b) is also being revised to provide that the “3x” cap on relevant contributions during a Cooling-off Period applies to both Assessment Contribution and replenishments of the Relevant Guaranty Fund, in the aggregate, regardless of the number of defaults during the period. The foregoing cap is based on a Clearing Member’s individual Guaranty Fund Contribution immediately prior to the default that triggered the Cooling-off Period. (As set out in Rule 917(b)(iii), the existing single-default cap on Assessment Contributions under Rule 909 would also continue to apply in a Cooling-off Period.) The amendments will also allow ICE Clear Europe to rebalance, reset and recalculate the Relevant Guaranty Fund during the Cooling-off Period, but such changes do not affect the aggregate 3x contribution limit. Under new Rule 917(e), Clearing Members that have made the maximum contribution during a Cooling-off Period could be required to provide additional proprietary initial margin during the period, which would facilitate ICE Clear Europe’s ability to continue to satisfy its regulatory minimum financial resources requirements.

#### V. Clearing Member Withdrawal.

Existing Rules 209 and 918, which address withdrawals by Clearing Members (other than CDS Clearing Members), are being revised to apply to the CDS Contract Category, such that the Rules apply to all ICE Clear Europe Clearing Members and Sponsored Principals. Under revised Rule 917(c), CDS Clearing Members (like other

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<sup>6</sup> See, e.g., ICE Clear Credit Rule 102 (definition of “Cooling-off Period”).

Clearing Members) and Sponsored Principals may withdraw from ICE Clear Europe during a Cooling-off Period by providing an irrevocable notice of withdrawal in the first 10 business days of the period (subject to extension in certain cases if the Cooling-off Period is extended). CDS Clearing Members may withdraw from ICE Clear Europe at other times by notice to ICE Clear Europe under Rule 209. Rule 209 would also permit ICE Clear Europe to terminate a CDS Clearing Member's membership on 30 business days' notice, consistent with its authority with respect to Clearing Members in other Contract Categories. In case of withdrawal or termination, all outstanding positions need to be closed out by a specified deadline, generally within 20 to 30 business days following notice of withdrawal under Rule 918(a) and 209(c). Withdrawal will not be effective, pursuant to Rule 918, until the Clearing Member or Sponsored Principal closed out all outstanding positions and satisfied any related obligations, and a withdrawing Clearing Member or Sponsored Principal will remain liable under Rule 918 with respect to charges and assessments resulting from defaults that occurred before such time. Under the rule change, a CDS Clearing Member that seeks to withdraw other than during the first 10 business days of a Cooling-off Period may, at the direction of ICE Clear Europe under Rule 209(d), be required to make a deposit of up to three times its required Guaranty Fund Contribution (this provision already applies to F&O Clearing Members). Such a deposit would not impose new liabilities on the Clearing Member, but provide assurance that the withdrawing Clearing Member would continue to meet its obligations in respect of defaults and potential defaults before its withdrawal would be effective. It thus reduces the potentially destabilizing effect that Clearing Member withdrawal (or a series of Clearing Member withdrawals) could have on the Clearing House during a stressed situation. Rule 918(a)(viii)(B) also specifies the timing for the return of Guaranty Fund Contributions to a withdrawing Clearing Member or Sponsored Principal.

#### VI. Clearing Service Termination.

The amendments extend the existing provisions of Rules 105(c), 912 and 916, which provide for full clearing service termination for one or more Contract Categories, to the CDS Contract Category.

Rule 105(c) will apply where the Clearing House determines to cease acting as a Clearing House, whether generally or in relation to a particular class of Contracts. It will provide for the application of the procedures and terms in specified sections of Rule 918 to effect termination of the relevant contracts, including the timing of termination and the determination of the termination price.

Rule 916 will permit the Clearing House to terminate an entire Contract Category in certain circumstances following an Event of Default, including where there has been an Under-priced Auction or the Clearing House otherwise does not believe it will have sufficient assets to perform its obligations in respect of that Contract Category. Rule 916 will set out procedures for such termination, including notice of termination and calculation of the termination timing and price. Under the amendments, ICE Clear Europe will be permitted to use the procedures of Rule 916 in connection with the CDS Contract Category, in addition to the F&O Contract Categories currently covered by the Rule.

In addition, Rule 912, which provides for contract termination upon Clearing House insolvency and failure to pay events, will be extended to apply to CDS Contracts as well as F&O Contracts. Certain other conforming changes will be made in Rule 912.

## VII. Additional Changes.

ICE Clear Europe is making certain additional changes to the Rules that are generally in the nature of drafting improvements and updates, clarifications and conforming changes. In particular, Rule 101 is being revised to add new defined terms that are used in the rule changes discussed above, such as those relating to Assessment Amounts, CDS Default Auction Procedures, Default Auctions, Default Auction Procedures, Initial CDS Auction, Relevant Contract Categories, Secondary CDS Auction and Under-priced Auction. Certain such defined terms are being moved from Rule 913 to Rule 101. Updates to the definitions relating to recovery provisions in Rule 913 are also being made, consistent with the changes discussed herein.

Certain other conforming changes are being made throughout the Rules to reflect the new default management tools and provisions discussed above and related defined terms, including in Part 15 of the Rules. Rule 903(d) is being amended to align treatment of automatic default termination provisions for all Contract Categories. In Rule 906, "OA" is being revised to clarify that certain amounts payable to Clearing Members in respect of Guaranty Fund Contributions, assessments, reduced gains distribution, partial tear-up and collateral offset obligations are being taken into account in that component of the net sum calculation. In addition, certain clarifications and conforming updates are being made in Part 12 of the Rules. Rule 1901(k) is being amended to provide that Sponsored Principals may be required to participate in Default Auctions. Certain other typographical and cross-reference corrections are being made throughout the Rules.

ICE Clear Europe is also making an amendment to its Clearing Procedures to reflect the renaming of its risk model.

### ***Compliance with the Act and CFTC Regulations***

The rule amendments are potentially relevant to the following core principle: (B) Financial Resources, (D) Risk Management, (E) Settlement Procedures, (G) Default Rules and Procedures and (R) Legal Risk, and the applicable regulations of the Commission thereunder.

#### *Financial Resources.*

- The amendments are designed principally to address the risks posed to ICE Clear Europe by a significant default by one or more Clearing Members or Sponsored Principals. ICE Clear Europe's funded margin and Guaranty Fund resources are designed to be sufficient to meet ICE Clear Europe's financial obligations in respect of CDS Contracts to CDS Clearing Members notwithstanding a default by the two CDS Clearing Member families creating the largest combined loss, in extreme but plausible market conditions, consistent with relevant regulatory requirements. The amendments will not reduce such funded resources. The amendments are intended to enhance and provide greater certainty as to the additional resources, beyond the funded

margin and Guaranty Fund resources, that would be available to support CDS clearing operations in more extreme CDS Clearing Member and Sponsored Principal default scenarios.

- As described above, the amendments also maintain the existing limitation on assessment contributions per default, and impose a new limitation on CDS Guaranty Fund replenishments and assessments during a Cooling-off Period. The amendments require that Clearing Members continue to replenish the Relevant Guaranty Fund and meet assessment obligations during the Cooling-off Period, subject to an aggregate 3x limit. In addition, in the event the 3x limit is reached, the amended rules would allow ICE Clear Europe to call on Clearing Members for additional initial margin in order to ensure that it maintains sufficient resources to comply with applicable minimum regulatory financial resources requirements. In ICE Clear Europe's view, these changes would provide an appropriate balance between several competing interests of the Clearing House and Clearing Members. Although the amendments could in theory limit the maximum resources available to the Clearing House (as compared to the absence of a cap), the changes provide greater certainty for Clearing Members as to their maximum liability with respect to the relevant Guaranty Fund in the event of defaults (and thus their maximum amount of mutualized risk), in order to facilitate their own risk management, regulatory and capital considerations. This greater certainty is in turn intended to help stabilize the Clearing House during a period of significant stress, including where there are multiple defaults. In particular, a Cooling-off Period and limit on assessments may reduce the risk of cascading defaults, where the financial demands placed on non-defaulting Clearing Members for repeated assessments or replenishments could cause such Clearing Members to themselves experience financial stress or even default, which could make the default management process more difficult. The period is designed to give the Clearing House time to work out the default without exacerbating these stresses, while also allowing the Clearing House and Clearing Members time to assess whether the defaults would be able to be resolved and normal clearing would be able to resume.
- In addition, the amendments ensure that ICE Clear Europe maintains sufficient resources to enable it to continue operations in compliance with minimum regulatory financial resources requirements, either through replenishment of the Relevant Guaranty Fund in the normal course, or in an extreme situation where the 3x cap is reached, by providing ICE Clear Europe the ability to call for additional initial margin.<sup>7</sup>

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<sup>7</sup> ICE Clear Europe recognizes that the ability to call for such additional initial margin, particularly in times of stress, could have a potential procyclical impact and potential liquidity impact on Clearing Members and their customers that is greater than guaranty fund replenishment, because initial margin is not subject to mutualization. As a result, the amount of additional initial margin required could exceed the amount of guaranty fund replenishment that would be required in the absence of the 3x cap. At the same time, ICE Clear Europe believes that these risks would be limited to a particular remote loss scenario, and would be mitigated by certain factors. ICE Clear Europe expects to limit the additional margin to the amount necessary to maintain minimum regulatory financial resources compliance, which may be less than the amount ICE Clear Europe would otherwise require under its Guaranty Fund methodology. ICE Clear Europe also expects that over the course of a Cooling-off Period, aggregate potential stress losses, and thus the need for additional financial resources, would generally decrease. In particular, Sponsored Principals and Clearing Members (and their customers) have the opportunity

- The Clearing House is reducing the length of the Cooling-off Period to a duration of 30 calendar days (which will apply to all Contract Categories) which is intended to be long enough to provide the Clearing House and Sponsored Principals with a measure of stability and predictability as to the use of guaranty fund resources and avoid incentivizing Clearing Members and Sponsored Principals to withdraw from the Clearing House following a default. In the case of CDS Contracts, this period would also be consistent with the timeframe for the normal, periodic recalculation of ICE Clear Europe's guaranty fund under Part 11 of the Rules and the Finance Procedures (which is done on a monthly basis), a period that ICE Clear Europe has found appropriately balances stable Guaranty Fund requirements with the ability to make changes as necessary. ICE Clear Europe also believes, based on its analysis, that 30 days has historically been an adequate period for the market to stabilize following a significant default event. (This was, for example, observed in the interest rate swap market following the Lehman insolvency.) In ICE Clear Europe's view, the 30-day Cooling-off Period and assessment and replenishment limits balance the interests of the Clearing House, Sponsored Principals and Clearing Members and in the aggregate enhance the likelihood that the Clearing House can withstand a default.
- In ICE Clear Europe's view, for the foregoing reasons, the amendments described above are consistent with the financial resources requirements of Core Principle B and Commission Rule 39.11.

*Risk Management.*

- ICE Clear Europe is not changing its existing risk methodology or margin framework for CDS Contracts, which are its initial lines of defense against losses from Clearing Member or Sponsored Principal default. As discussed herein, the amendments provide additional default tools and procedures, including initial and secondary CDS auction procedures, reduced gain distribution for the CDS Contract Category, and partial tear-up, for addressing the risk of extreme default scenarios that may not be able to be addressed by standard risk management and default procedures. The enhanced procedures for full CDS clearing service termination would also serve as a means of addressing operational and other risks that may otherwise threaten the operation of the Clearing House. In ICE Clear Europe's view, the amendments will overall facilitate its ability to effect recovery or wind-down, if necessary, in connection with extreme loss events.
- ICE Clear Europe further believes that its operational systems and capabilities are sufficient to support the rule changes and new default management tools

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during the Cooling-off Period to reduce or rebalance the risk in their own portfolios, and thus mitigate potential stress loss and exposure to initial margin increases. Sponsored Principals and Clearing Members and their customers could also participate in default management (through participation in auctions), which would help them reduce their own risk profile. In addition, and most importantly, additional initial margin posted by Sponsored Principals and Clearing Members would not be subject to mutualization and could not be used to cover defaults of other Sponsored Principals and Clearing Members. As a result, while Sponsored Principals and Clearing Members could be required to post more funds as additional initial margin than in a replenishment of a mutualized Guaranty Fund, the risk of loss to Sponsored Principals and Clearing Members of those additional margin funds is substantially less than for Guaranty Fund replenishment.

that would be implemented under the amendments. For the most part the changes extend to the CDS Contract Category Rules certain procedures and tools that already apply to the F&O Contract Category. Accordingly, ICE Clear Europe has developed various systems relating to the default management process, and has done significant work to incorporate its F&O recovery tools and procedures in those systems. Once the rule amendments become effective, ICE Clear Europe would complete the incorporation of those tools into its systems for CDS Contracts, and test such systems as part of its regular system testing process.

- In ICE Clear Europe's view, the amendments are therefore consistent with the risk management requirements of Core Principle D and Commission Rule 39.13.

#### *Settlement Procedures.*

- The amendments do not affect normal settlement procedures for the Clearing House. Amendments to Rule 110(f) contemplate that solely on an intra-day basis, the Clearing House may delay outbound variation margin or mark-to-market margin payments in certain cases where a Clearing Member or Sponsored Principal has failed to make a corresponding payment to the Clearing House. The amendment will facilitate the ability of the Clearing House to complete its daily settlement cycle, in accordance with Core Principle E and Commission Rule 39.14.
- The amendments also contemplate that as a secondary default management step, in extreme cases, ICE Clear Europe could implement reduced gains distributions for CDS Contracts for up to five business days where it has exhausted all other financial resources (including assessment contributions). In such case, ICE Clear Europe would continue to collect mark-to-market margin owed to it from all non-defaulting Clearing Members, but would reduce outbound payments of mark-to-market margin owed to Sponsored Principals and Clearing Members to reflect available resources. ICE Clear Europe would calculate the haircut amount for CDS Contracts on a daily basis for each day of reduced gains distribution, without consideration of reductions on prior days. Consistent with the requirements, as a result, settlement on any day of reduced gains distributions for CDS Contracts would be final, as ICE Clear Europe would not have any ability to reverse or unwind the settlement. As a result, in ICE Clear Europe's view, the amendments are consistent with the settlement finality requirements of Core Principle E and Commission Rule 39.14.

#### *Default Rules and Procedures.*

- The amendments clarify and augment the Rules and procedures relating to default management, with the goal of enhancing the ability of the Clearing House to withstand extreme default events, particularly for CDS Contracts (which were not covered by the F&O Recovery Rule Amendments). For CDS Contracts, the amendments more clearly distinguish between standard default management events, largely covered by its existing default rules and procedures, and more extreme default management scenarios, for which recovery tools may be appropriate. The amendments include a new set of

procedures for Initial CDS Auctions, designed to facilitate liquidation of the defaulter's portfolio through a multi-lot modified Dutch auction. The auction procedures require participation of all CDS Clearing Members (unless outsourced to another Clearing Member in accordance with the Rules), and permit direct participation in the auction by customers as well as Clearing Members and Sponsored Principals. ICE Clear Europe believes that such participation will lead to more effective and efficient auctions, and give market participants greater opportunity to protect against the possibility of partial tear-up and reduced gains distribution. The procedures also provide incentives for competitive bidding through juniorization of Guaranty Fund and assessment contributions. The amendments further include a set of procedures for Secondary CDS Auctions, intended to provide for an effective final auction of the entire remaining portfolio, prior to the exercise of other recovery tools such as partial tear-up.

- Following consultation with Clearing Members, ICE Clear Europe is removing the existing CDS default management tool of forced allocation, in light of concerns that the tool could result in unpredictable and unquantifiable liability for CDS Clearing Members. Instead, ICE Clear Europe will have the option to invoke a partial tear-up of CDS positions to restore a matched book in the event that it would be unable to auction the defaulter's remaining portfolio. The amendments also permit the use of partial tear-up for other Contract Categories. Partial tear-up, if used, would occur at the most recent mark-to-market or settlement price determined by ICE Clear Europe, contemporaneously with such determination. As a result, partial tear-up would not result in additional loss to Clearing Members or Sponsored Principals as compared to the most recent mark to market settlement (and if reduced gains distribution is invoked, partial tear-up will not entail additional loss beyond that resulting from such reduced gains distribution). ICE Clear Europe believes that this revised set of tools would maximize the Clearing House's ability to efficiently, fairly and safely manage extreme default events. The amendments further provide for the allocation of losses that exceed funded resources, through assessments and replenishments to the Guaranty Fund, as described herein, and the use of reduced gains distributions when necessary, following the exhaustion of all other resources. The amendments thus are designed to permit ICE Clear Europe to fully allocate losses arising from default by one or more Clearing Members or Sponsored Principals, with the goal of permitting the Clearing House to resume normal operations. Furthermore, ICE Clear Europe contemplates testing of the use of the new tools and procedures as part of its regular default management exercises, in order to identify and manage any related operational risks. The results of such testing would be shared with appropriate ICE Clear Europe risk and governance committees and regulators, consistent with the treatment of the results of other default management testing.
- As a result, in ICE Clear Europe's view, the amendments would allow it to take timely action to contain losses and liquidity pressures and to continue meeting its obligations, consistent with the requirements relating to default rules and procedures set out in Core Principle G and Commission Rule 39.16.

### *Legal Risk.*



- ICE Clear Europe believes that the amendments provide a clearer and more transparent set of default management procedures for addressing extreme loss events in the CDS Contract Category, in a manner that is largely consistent with the approach already used for the F&O Contract Category. These changes (including the elimination of the Continuing CDS Rule Provisions), and the greater harmonization among product categories, would provide greater certainty to the Clearing House, Clearing Members, Sponsored Principals and other market participants as to the various tools available to the Clearing House and the potential liabilities of Clearing Members, Sponsored Principals and others in such events. ICE Clear Europe further believes that the amendments facilitate the Clearing House's ability to conduct an orderly recovery or, if necessary, wind-down process, in accordance with the requirements of applicable regulations. ICE Clear Europe has in addition considered legal advice of internal and external counsel with respect to the implementation of the amendments. As a result, ICE Clear Europe believes the amendments will facilitate operation of the Clearing House pursuant to a well-founded, transparent and enforceable legal framework, and are thus consistent with the requirements of Core Principle R and CFTC Rule 39.27.

### ***Consultation with Clearing Members***

The amendments have been discussed with Clearing Members (individually and as a group). The amendments have been developed over the course of several years, and throughout that time ICE Clear Europe has consulted with Clearing Members on both the overall design and the detailed drafting of the amendments. Several aspects of the amendments reflect requests and concerns identified by Clearing Members, as discussed above (both through direct discussions and from public statements by Clearing Members and other market participants concerning recovery and wind-down issues for clearing generally), including the removal of forced allocation, introduction of a Cooling-off Period for CDS Contracts and establishment of aggregate limitations on assessments and replenishments. The introduction of partial tear-up and reduced gains distributions as recovery tools have also been discussed with Clearing Members, and have been drafted to take into account suggestions raised by Clearing Members, including to define the circumstances in which those tools may be used and to limit the adverse impact of such tools on netting, regulatory capital and other matters.

Certain CDS Clearing Members have expressed concern in particular with the potential use of reduced gains distribution as a recovery tool. While ICE Clear Europe believes reduced gains distribution is an important tool for ensuring its ability to fully allocate losses, ICE Clear Europe has, in light of such concerns, limited the use of reduced gains distribution for CDS Contracts to scenarios in which all other funded financial resources of the Clearing House have been exhausted. ICE Clear Europe has also consulted with CDS Clearing Members on the details of the Initial CDS Auctions and Secondary CDS Auction procedures, and has taken into account comments and suggestions concerning such matters as minimum bid requirements, use of a Dutch versus other auction methodologies, degree and triggers for juniorization and participation by customers. ICE Clear Europe has shared drafts of the amendments with Clearing Members, and informally sought (and received) comment from Clearing Members and Clearing Members' internal and external

counsel on such drafts, which ICE Clear Europe has taken into consideration in the drafting of the amendments.

ICE Clear Europe has conducted a public consultation with respect to the amendments. ICE Clear Europe received one written comment on the amendments as set out in the consultation, which questioned whether reduced gains distribution for CDS Contracts is appropriate prior to the exhaustion of assessment contributions. ICE Clear Europe believes the approach it has taken is appropriate, as Rule 914(n) requires both that (1) all available resources other than assessment contributions have been exhausted, and (2) assessments have been called and have become due and payable, before ICE Clear Europe can implement reduced gain distribution for CDS Contracts. The approach reflects the risk that unfunded assessments may not be paid when due, and further provides that any reduced gains distributions made will be reimbursed through assessments when received.

As set forth herein, the amendments consist of changes to the Rules, a copy of which is attached hereto.

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

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 [carolyn.vandendaelen@theice.com](mailto:carolyn.vandendaelen@theice.com) or +44 20 7429 4515.

Very truly yours,

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