



December 11, 2017

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:
Procyclicality Framework

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

ICE Clear Europe is adopting a new Procyclicality Framework, in order to establish an overall framework for the risk appetite, model design, monitoring and assessment and management of procyclicality in the risk models used by ICE Clear Europe to manage default risk. The European Market Infrastructure Regulation¹ (“EMIR”) and related implementing standards require that a central counterparty (“CCP”) ensure that its margin framework provides, among other matters, stable and prudent margin requirements that limit procyclicality to the extent that the soundness and financial security of the central counterparty is not negatively affected.² Those standards also

¹ Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories, as well as various implementing regulations and technical standards.

² Article 28 of Commission Delegated Regulation (EU) No 153/2013 of 19 December 2012 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on requirements for central counterparties.

require that central counterparties implement at least one of several specified options for mitigating procyclicality with respect to margin requirements.³

Although ICE Clear Europe's current margin policies incorporate the anti-procyclicality ("APC") measures required by EMIR (and ICE Clear Europe does not propose to change such measures at this time), it is adopting the Procyclicality Framework in order to provide a more defined framework for considering the impact of procyclicality on margining, membership, collateral haircuts, stress testing and concentration risk policies. The framework is designed to set out (1) the aspects of ICE Clear Europe risk policies relevant to procyclicality considerations, (2) how the clearing house will assess procyclicality (both as a qualitative and a quantitative matter) and (3) how the clearing house will factor considerations of procyclicality into its response to emerging risks. ICE Clear Europe is not making any changes to its Clearing Rules or Procedures in connection with the adoption of this framework.

Although "procyclicality" is not expressly defined in EMIR, ICE Clear Europe considers procyclicality for purposes of the framework to be the extent to which changes in market conditions can have an effect on a clearing member's ability to manage its liquidity to meet ICE Clear Europe's changing margin requirements. For example, a typical initial margin model would require increased margin in stressed margin conditions, and such increases may potentially occur rapidly and/or over-react to the change in conditions. Such margin increases, in turn, may stress a clearing member's ability to obtain liquidity to meet the increased requirements.

The framework identifies sources of procyclicality, in particular in margin models, stress testing, and collateral haircut policies, and references existing mitigation strategies and stress testing arrangements used by the clearing house. Stress testing scenarios that are based on models similar to margin models but targeting a higher confidence quantile may also be procyclical due to changing market conditions, which may lead to increased stress shock results and therefore affect default fund requirements.

The framework also addresses how ICE Clear Europe intends to address procyclicality on an ongoing basis. Under the framework, ICE Clear Europe will assess procyclicality by monitoring the 95th percentile expected shortfall of the 5-day percentage change in initial margin (or other relevant risk mitigant) over a rolling 250-day window. ICE Clear Europe established this period, in consultation with Clearing Members, as an appropriate period to reflect short-term spikes in margin. ICE Clear Europe will also monitor the largest percentage changes to facilitate observation of both the maximum and a tail estimate to remove extreme outliers. A red-amber-green ("R-A-G") escalation framework will be used with respect to implementing APC measures based on certain defined thresholds for expected 95th percentile expected shortfall metric, which are detailed in an appendix to the framework. The escalation framework specifies appropriate responses where the expected shortfall level is at an amber or green level. ICE Clear Europe will assess

³ The CPMI-IOSCO Principles for Financial Market Infrastructures ("PFMIs") similarly provide that a clearing house should limit procyclicality for margin requirements and haircuts. See Principles 5 (Collateral) and 6 (Margin).

procyclicality both on a regular basis in monitoring model performance and making margin rate adjustments as part of risk model design.

In addition to the quantitative metrics, there are a number of qualitative inputs that are given consideration under the framework. For example, ICE Clear Europe will take into consideration the periodicity of margin updates and will attempt to mitigate the effect of such updates by communicating any such updates to the cleared markets up to a week in advance. The framework also includes procedures for considering the impact of prospective margin changes on the portfolios of Clearing Members and communicating with Clearing Members that may be significantly affected by such changes. The framework also takes into account the activities of other CCPs in the relevant market, expectations of market participants, the potential for moral hazard created by an expectation of gradual margin changes, and the ability of the clearing house to override normal APC measures in extreme circumstances. The framework recognizes that different APC measures and thresholds may be appropriate in different markets based on their historical performance. ICE Clear Europe also takes into account the different liquidity resources and practices of different types of Clearing Members, including banks, broker-dealers and other traders, and the need for margin add-ons to mitigate particular liquidity and/or concentration risks. The framework also sets out APC considerations for new products and material changes in existing products.

Pursuant to the framework, ICE Clear Europe will disclose its APC methodology on its website. The framework further provides for ongoing governance and review by the relevant product risk committees and board risk committee, as appropriate.

Compliance with the Act and Commission Regulations

The rule amendments are potentially relevant to the following core principles: (D) Risk Management and (R) Legal Risk, and the applicable regulations of the Commission thereunder.

- *Risk Management.* The amendments are designed to enhance and formalize the overall assessment and management of procyclicality in the clearing house's margin and haircut models, consistent with regulatory requirements under EMIR. The adoption of the Procyclicality Framework is thus intended to strengthen the risk models and procedures already used by the clearing house, particularly the margin model, and limit on an ongoing basis the risks of procyclicality for Clearing Members and the clearing house itself. The framework will also provide greater clarity and transparency for Clearing Members and others as to the clearing house's approach to managing procyclicality. The policy thus will facilitate the Clearing House's ability to manage the risks with respect to procyclicality, consistent with the requirements of Core Principle D and Commission Rule 39.13.
- *Legal Risk.* The Procyclicality Framework is being adopted to facilitate compliance with certain requirements under EMIR relating to procyclicality. In ICE Clear Europe's view, the adoption of the framework is thus consistent

with the legal risk requirements of the Clearing House under Core Principle R and Commission Rule 39.27.

As set forth herein, the amendments consist of the adoption of the new Procyclicality Framework. ICE Clear Europe has requested confidential treatment with respect to the framework, which has been submitted concurrently with this self-certification submission.

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 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 or Dee Blake, Director of Regulation, at dee.blake@theice.com or +44 20 7065 7752.

Very truly yours,



Patrick Davis
Head of Legal and Company Secretary