



January 27th, 2020

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

Re: Self-Certification Pursuant to Commission Rule 40.6 – Collateral and Haircut
Policy and Procedure

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, proposes to adopt a new Collateral and Haircut Policy (the “Revised Policy”) to replace the existing Collateral and Haircut Policy (the “Existing Policy”) and to adopt new Collateral and Haircut Procedures (the “Collateral Procedures”). The revisions would not involve any changes to the ICE Clear Europe Clearing Rules or Procedures. 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 proposing to adopt the Revised Policy and new Collateral Procedures. Together, the Revised Policy and Collateral Procedures would supersede the Existing Policy, which would be retired. The new documents would provide certain clarifications and better separate policy-level documentation and implementation-level documentation, such that high-level policy details would be in the Revised Policy and supporting detail for the Revised Policy would be contained in the new Collateral Procedures. Accordingly relevant parts of the Existing Policy would be split between the Revised Policy and the Collateral Procedures. The amendments also remove certain operational details in the Existing Policy which ICE Clear Europe has determined are not needed in the Revised Policy and Collateral Procedures. Nonetheless, ICE Clear Europe does not expect that the new documentation would itself result in material

changes to its underlying haircut model, or to the eligible collateral, haircuts and concentration limitations that the Clearing House currently imposes.

Collateral and Haircut Policy

The Revised Policy would set out the Clearing House's overall approach to defining the types, amounts and composition of cash and non-cash collateral that ICE Clear Europe accepts from Clearing Members ("CMs") to cover their guaranty fund and margin requirements (referred to generally as "collateral"). The Revised Policy would set out the Clearing House overall goal of mitigating price risk it may face when liquidating collateral of a defaulting CM by: (i) setting and enforcing a list of acceptable collateral (also referred to as "Permitted Cover"); (ii) setting and applying risk-based haircuts to the value of the collateral ("Haircuts"); (iii) setting and enforcing concentration limits on the amount of collateral a CM may post, to provide diversification of the collateral pool ("Concentration Limits"); and (iv) ensuring Permitted Cover, Haircuts and Concentration Limits are aligned to the Clearing House's risk appetite and compliant with applicable legal and regulatory requirements.

The Revised Policy would set out overall requirements that Permitted Cover assets: (i) are highly liquid with low credit and market risk; (ii) are priced in an Eligible Currency; and (iii) entail risks limited to those that ICE Clear Europe is able to identify, measure, monitor and mitigate. (The specific list of Permitted Cover would not be contained in the Revised Policy itself but would continue to be available on the ICE Clear Europe website.)

The Revised Policy would set overall requirements that Haircuts would be based on a model that includes: (i) the creditworthiness of the issuer; (ii) the asset's market risk and liquidity risk; and (iii) market conditions and volatility. Certain further details relating to Haircuts (including the determination of minimum haircuts) would be specified in the Collateral Procedures, or in related model documentation. The Revised Policy would also establish the general principal that wrong way risk ("WWR") with respect to posting of collateral (i.e., the risk that the value of a particular CM's collateral is likely to decline at the same time the Clearing House's risk to the CM increases) would be mitigated through member-specific restrictions and actions rather than Haircuts. The Revised Policy would address the overall framework for setting CM Concentration Limits. It would provide that ICE Clear Europe may limit (i) the absolute amount of each type of collateral that CMs may lodge to minimize concentration and enable liquidity and (ii) the relative amount of each collateral type in a CM's collateral portfolio to prevent overexposure to price movements in individual asset classes. Collateral exceeding Concentration Limits would not count towards a CM's total margin requirements. As discussed below, details regarding collateral management, data and reporting and legal review of enforceability of collateral found in the Existing Policy would be split across the Revised Policy, Collateral Procedures, ICE Clear Europe Collateral and Haircut Schedule of Parameters and Reviews (the "Parameters") and the Model Documentation for the ICE Clear Europe Collateral Haircut Model (the "Model"). Where details are included in other Clearing House policies, procedures and documentation, such as the Treasury & Banking Services Policy, Investment Management Policy, F&O Risk Policy, Document Governance Schedule and Risk

Appetite Framework, to avoid duplication, they would not be covered in the Revised Policy.

The Revised Policy would describe overall arrangements for policy governance, reviews and exception handling. Pursuant to the Revised Policy, the document owner would be responsible for ensuring that it remains up-to-date and appropriately reviewed and would report material breaches and deviations to their Head of Department, the Chief Risk Officer and the Head of Compliance (or their delegates), who together would then consider further escalation to relevant senior executives, the Board and/or competent authorities. Exceptions to the Revised Policy would be approved in accordance with applicable governance processes.

Collateral and Haircut Procedures

The new Collateral Procedures would set out the application of the Revised Policy through describing the operational activities and related governance processes for Permitted Cover, Haircuts and Concentration Limits. Certain details contained in the Existing Policy have been incorporated in the Collateral Procedures, rather than the Revised Policy, as discussed herein.

Permitted Cover

The Collateral Procedures would provide more detail regarding requirements relating to Permitted Cover. These requirements are generally consistent with the Existing Policy, and ICE Clear Europe does not expect that the adoption of the new Collateral Procedures would result in a change in the list of Eligible Permitted Cover. The Collateral Procedures would apply the following general eligibility criteria to Permitted Cover:

- The assets must be highly liquid with an active sale or repurchase agreement market with a diverse group of buyers and sellers;
- The market for the assets must have sufficient price history to permit ICE Clear Europe to analyze the statistical returns of the assets;
- The assets must be capable of daily revaluation and must be quoted intraday by financial market news information providers;
- ICE Clear Europe must be capable of managing the assets operationally; and
- The assets must be in an Eligible Currency.

Where the asset is a financial instrument, generally the following additional criteria would apply:

- The asset must be a vanilla form of that instrument;
- The asset must have low credit risk and low market risk, based on ICE Clear

Europe's internal assessment based on credit and bond yield and CDS spread relative to the maximum set by ICE Clear Europe and

- The asset must be freely transferable and without any regulatory or legal constraint or third party claims that impair liquidation;
- The asset must not be issued by a CM, or an affiliate of a CM; and
- The asset must not be issued by a central clearing counterparty or entity providing services critical to the functioning of ICE Clear Europe (unless it is a central bank in the European Economic Area or that issues a currency in which ICE Clear Europe has exposures).

Where the asset is gold, one of the following additional criteria would apply:

- It must be owned as allocated gold (where ICE Clear Europe directly holds an interest in specific bars of gold); or
- It must be owned as unallocated gold (where ICE Clear Europe holds an interest in a pool of gold bars) through a firm with low credit risk based on ICE Clear Europe's own assessment. The eligibility criteria described above, combined with the description of the concentration limits, basis for haircuts and steps to mitigate price risk set out in the Revised Policy, are consistent with the general principles for accepting Permitted Cover set out in the Existing Policy, other than the sovereign rating model criteria. The sovereign rating model has been retired by ICE Clear Europe and instead, the Procedures and related Parameters address sovereign quality. The elements related to sovereign rating are the same in the Existing Policy and in the new Collateral Procedures and Parameters. Consistent with current practice, letters of credit and bank guarantees would not be eligible as Permitted Cover. Certain additional details and parameters would be set out in an annex to the Procedure or in the List of Permitted Cover, which is an operational document that is published on the ice.com website.² Unlike the Existing Policy, the Collateral Procedures would not have a section specifically addressing restrictions on Guaranty Fund collateral as this is already be addressed in the Finance Procedures and List of Permitted Cover.

Haircuts

Pursuant to the proposed Collateral Procedures, ICE Clear Europe would continue to apply conservative haircuts to Permitted Cover to ensure that, even in stressed market conditions, the collateral could be liquidated at least at the value of the requirement it would be used to cover, and would also continue to apply cross-currency haircuts to mitigate foreign exchange risk where the currency applicable to the collateral would be different from the currency of the requirements it would be covering.

ICE Clear Europe would determine Haircuts using a combination of a model, analytical tools and/or qualitative overlays. The model would be described in the collateral and haircut model documentation and related parameters maintained by the Clearing House and be backtested periodically. Consistent with the existing model, Haircuts would further be based on a number of factors, including, but not limited to:

- A credit assessment of the issuer;
- The maturity of the asset;

- Historical and current market conditions and volatility;
- Stressed market conditions, including both historical and forward looking (hypothetical) scenarios based on macroeconomic or political events;
- Expectations of future volatility;
- The liquidity of the underlying market, including bid/ask spreads; and
- Any other factors that may affect the liquidity or the value of the asset in stressed market conditions.

These factors are substantially the same as those set out in the Existing Policy, other than the wrong way risk factor, which is addressed through an operational report, and as noted above is addressed through CM-specific measures rather than Haircuts. The Haircuts would be subject to minimum values which would be addressed in the Parameters, instead of the Revised Policy or Collateral Procedures, and the final Haircut value would be rounded up to the nearest “Haircut Rounding Interval”. Certain additional requirements relating to Haircuts on bonds and gold bullion, as well as collateral pricing, which are currently addressed in the Existing Policy, would be removed from the Existing Policy as they are already addressed, and will continue to be addressed, in the Model and the Parameters. Other aspects of the haircut calculation methodology would also move to the related collateral haircut model documentation. The list of data used in collateral pricing that is currently set out in the Existing Policy would instead be set out in the Parameters. The description of exceptions would be set out in Clearing House operational documentation.

Consistent with the Existing Policy, the Collateral Procedures would call for ICE Clear Europe to limit the likelihood of procyclical impact from Haircuts as issuer creditworthiness deteriorates and haircuts increase by:

- Applying a conservative minimum haircut level to all collateral types, regardless of issuer and tenor;
- Including stressed market conditions in the Haircuts;
- Pre-emptively identifying and incorporating potential future events into the

Haircuts via the qualitative overlays and analytical tools; and

- Providing advance notice of changes in haircuts to CMs and competent authorities, where practicable.

Concentration Limits

The approach to Concentration Limits contained in the proposed Collateral Procedures would be substantially similar to the Existing Policy. However, certain details regarding the collateral breakdown report currently in the Existing Policy would not be included in the Collateral Procedures (as they are inconsistent with the level of detail in the Collateral Procedures generally) but would instead be set out in operational

documentation. The report itself, which details how collateral values are produced at an operational level, will continue to be produced as part of the normal reporting cycle. As under current practice, ICE Clear Europe would be able to set Absolute Limits and Relative Limits. With respect to the absolute amount of each type of collateral that can be accepted from a CM (“Absolute Limits”), the Collateral Procedures would set the framework for how this level is set. ICE Clear Europe would limit the absolute amount of each type of collateral such that if two CM groups were to default, ICE Clear Europe’s total holdings of a particular type of collateral (across all of ICE Clear Europe’s markets) could be liquidated with minimal impact on prices. As compared to the Existing Policy, the Collateral Procedures would clarify that all markets cleared by ICE Clear Europe would be included in the calculation methodology for Absolute Limits. The description of the Absolute Limits in the Collateral Procedures would otherwise generally be consistent with the description of the Absolute Limits set out in the Existing Policy, including the description of the calculation of Absolute Limits for bonds lodged as Permitted Cover.

The Absolute Limits would be set as a percentage of the Daily Traded Volume, which is an average market volume for each asset and converted from the reported currency to the currency of the asset (where required) using the previous end of day foreign exchange rate. The Absolute Limits could be adjusted based on certain qualitative considerations and must be approved by senior management. Absolute Limits would be specified in the currency of the issuer, based on the market values of the collateral, and apply at a CM group level. Unlike the Existing Policy, the Collateral Procedures would not take into account ICE Clear Europe’s committed repo facility as a basis for allowing Clearing Members to exceed otherwise applicable Absolute Limits.

With respect to the relative amount of each type of collateral within a CM’s collateral portfolio (“Relative Limits”), the Collateral Procedures would describe the general framework for setting these limits, which would be set so that an individual CM’s collateral portfolios would be balanced between different assets based on a qualitative assessment of the different types of collateral, taking into account factors such as the types of issuers, issuer credit risk and collateral liquidity and price volatility. The Relative Limits would be based on the post-haircut value of the collateral applied at the individual CM level.

Further Restrictions

Pursuant to the proposed Collateral Procedures, and consistent with current practice, ICE Clear Europe would apply additional restrictions and measures with respect to collateral as follows:

- reducing Absolute Limits once the CDS spread of the issuer breaches pre-defined levels;
- analyzing CMs’ non-cash collateral to identify WWR daily and where ICE Clear Europe identifies material WWR, requiring the CM to take mitigating actions, such as substituting the lodged Permitted Cover with alternative Permitted Cover; and

- not placing Concentration Limits on certain Permitted Cover because of the liquidity of the asset's market, its behavior under stress and wider risk management considerations.

The Collateral Procedures would address cross clearing house concentration limits consistently with the manner in which they are addressed in the Existing Policy

Data Management

Consistent with existing practice, the sources of data used for collateral valuation and for Haircuts and Concentration Limits would be approved and reviewed periodically at a senior level, though data could be excluded or corrected without senior approval to correct stale or incorrect prices where reliable updated values have been supplied or to exclude data in the observation period for the Absolute Limits credit risk percentage reduction if it is unduly volatile due to low trading volumes. The list of exclusions and corrections and related justifications would be reviewed periodically. ICE Clear Europe would monitor the end of day and intraday market data that it uses to value collateral against thresholds to ensure that the data is not 'stale', investigate breaches of these thresholds and take action to resolve them.

The existing F&O Risk Procedures covers all aspects of collateral requirements and collateral valuation (and provides for issuance of margin calls accordingly). Therefore data and reporting requirements for valuation purposes have been removed from the Revised Policy as the content is covered in the Intraday Shortfall section of the F&O Risk Procedures. In addition, the formula for collateral valuation is publicly available on the ICE Clear Europe website.³ The scope of the collateral documentation is limited to setting collateral haircuts and limits, and monitoring them against market performance.

Daily Monitoring

Pursuant to the proposed Collateral Procedures, ICE Clear Europe would continue daily monitoring processes to ensure the eligibility of the list of Permitted Cover, to ensure the adequacy of Haircuts and to enforce the Concentration Limits. ICE Clear Europe would monitor:

- (i) publically available sources for information affecting the eligibility of collateral on the list of Permitted Cover;
- (ii) the adequacy of its Haircuts daily, in near real time, by comparing each asset's price movement since the previous day to the Haircut for that asset; and
- (iii) collateral against the Concentration Limits, which, in the case of a breach, would require the collateral to be replaced with alternative Permitted Cover or allow ICE Clear Europe to call for additional margin.

Certain provisions of the Existing Policy relating to intraday valuation of collateral and the description of collateral composition reporting would not be included in the Collateral Procedures, as the topic is already covered in the F&O Risk Procedures,

which describe the valuation methodology of collateral and the related monitoring undertaken through the margin call process. The CDS Risk Procedures will be updated as part of the Policy and Procedures documentation review cycle to align with the F&O Risk Procedures with respect to this matter. Certain details under Data and Reporting in the Existing Policy concerning the reports that are available to various stakeholders in the form of periodic Collateral Reports, will not be included in the Revised Policy or Collateral Procedures. In ICE Clear Europe's view, these reports have evolved since the adoption of the Existing Policy, and in order to facilitate their continued development ICE Clear Europe does not believe they should be specified in detail in Clearing House procedures. Internal tools instead would describe how the reports would be built in greater detail and may be adjusted over time, without affecting the Revised Policy or Collateral Procedures. The back testing of the haircut parameters currently set out in the Existing Policy would be instead set out in the Parameters (and the substance of those parameters is not proposed to be changed). The description of the Risk Committee collateral reporting would be governed through the Terms of Reference for committees instead of through the Revised Policy or Collateral Procedures (and is not otherwise proposed to be changed).

Governance

Governance relating to Permitted Cover, collateral and Haircuts would generally remain the same as in the Existing Policy, though the Collateral Procedures would add that competent authorities would be notified of any material breaches. Pursuant to the proposed Collateral Procedures, proposals to add, remove, change or set Permitted Cover, Haircuts or Concentration Limits would also reviewed at a senior level and existing levels would be reviewed at least monthly, but could also be reviewed and changed ad hoc if needed. Amendments would be published by circular in advance of taking effect (where practicable) to CMs and relevant competent authorities.

The governance requirements relating to reviews, breach management and exception handling would be the same as those under the Revised Policy. Requirements under the Existing Policy relating to independent validation and policy review are covered in the Model Risk Governance Framework and Documentation Governance Schedule, and would not be addressed in the Revised Policy or Collateral Procedures.

Other Existing Policy Matters

A number of additional details currently set out in the Existing Policy would be removed and addressed in documentation other than the Revised Policy or Collateral Procedures. Collateral management would be set out in the Treasury and Banking Services Policy and the Investment Management Procedures. The monitoring schedule would be set out in the Parameters. The description of the legal review of enforceability of collateral that was set out in the Existing Policy is generally considered to be business as usual work for the legal team and would no longer be covered through policies.

Compliance with the Act and CFTC Regulations

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

- *Financial Resources.* The proposed amendments of the Collateral and Haircut Policy would provide clarity on the Clearing House overall goal of mitigating price risk it may face when liquidating collateral of a defaulting CM by: (i) setting and enforcing a list of acceptable collateral (also referred to as “Permitted Cover”); (ii) setting and applying risk-based haircuts to the value of the collateral (“Haircuts”); (iii) setting and enforcing concentration limits on the amount of collateral a CM may post, to provide diversification of the collateral pool (“Concentration Limits”); and (iv) ensuring Permitted Cover, Haircuts and Concentration Limits are aligned to the Clearing House’s risk appetite and compliant with applicable legal and regulatory requirements. ICE Clear Europe does not expect that the new documentation would itself result in material changes to its underlying haircut model, or to the eligible collateral, haircuts and concentration limitations that the Clearing House currently imposes. As such, the amendments will continue to facilitate the clearing house’s ability to value appropriately its financial resources and this meet its financial resources and liquidity requirements under Core Principle B and Rule 39.11.
- *Risk Management.* For similar reasons, the amendments also facilitate clearing house risk management. As noted above the updates will provide clarity on permitted cover, haircuts, concentration limits which remain aligned to the Clearing House’s risk appetite and compliant with applicable legal and regulatory requirements. ICE Clear Europe does not expect that the new documentation would itself result in material changes to its underlying haircut model, or to the eligible collateral, haircuts and concentration limitations that the Clearing House currently imposes. Therefore, the overall risk management of the Clearing House, is consistent with the risk management requirements of Core Principle D and Commission Rule 39.13.

As set forth herein, the amendments consist of changes to the Collateral and Haircut Policy and Procedures. ICE Clear Europe has requested confidential treatment with respect to these amendments, which have been submitted currently 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 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 huw.davies@theice.com or +44 20 7429 4558.

Sincerely,



Huw Davies
Compliance and Regulatory Analyst
ICE Clear Europe