April 28, 2021

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 – transition of the interest rates used for computing CDS Price Alignment Amounts

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, changes related to the transition of the interest rates used for computing CDS Price Alignment Amounts. These revisions do not require any changes to the ICEU Clearing Rules (the "Rules") or CDS Procedures (the "CDS Procedures").[1] The changes will become effective on the first business day following the tenth business day after submission, or such later date as ICE Clear Europe may determine.

Concise Explanation and Analysis

ICEU proposes to change the interest rates used for computing CDS Price Alignment Amounts on CDS Notional Margin Balances under paragraph 3 of the CDS Procedures. The target date of the transition is Monday, June 14, 2021, subject to any regulatory review or approval process. On the transition date, ICEU would begin calculating price alignment amounts for Euro ("EUR") denominated instruments using the Euro Short-Term Rate ("€STR") rather than the Euro Overnight Index Average ("EONIA") and for U.S. Dollar ("USD") denominated instruments using the Secured Overnight Financing Rate ("SOFR") rather than the Effective Federal Funds Rate ("EFFR"). Such changes do not require any revisions to the ICEU Rules or CDS Procedures or other written policies and procedures. In accordance with section 3.1 of the ICEU CDS Procedures, the CDS Price Alignment Amount is based upon the

[1] Capitalized terms used but not defined herein have the meanings specified in the Rules or the CDS Procedures.

applicable overnight rate notified by the Clearing House from time to time to CDS Clearing Members for each of the currencies in which Mark-to-Market Margin is paid.

The proposed changes are in response to requests by industry participants and follow similar changes for other cleared swap products. The European Central Bank's ("ECB") working group on EUR risk-free rates recommended €STR as the EUR risk-free rate and the replacement for EONIA in September 2018.[2] The ECB began publishing €STR in October 2019 and the working group is assisting the market in transitioning to €STR before EONIA is discontinued on January 3, 2022.[3] The Alternative Reference Rates Committee ("ARRC") was convened by the Federal Reserve Board and the Federal Reserve Bank of New York and identified SOFR as the rate representing best practice for use in certain new USD derivatives and other financial contracts in 2017.[4] The ARRC published a transition plan including specific steps and timelines to encourage the adoption of SOFR.[5]

Feedback from market participants has indicated a desire for one-time adjustment payments to or from the Clearing Member ("CM"), as appropriate, to account for the reasonably expected valuation changes for Contracts associated with the use of the new interest rates. ICEU proposes to calculate such one-time adjustment payments to or from the CM, as appropriate, and to make the corresponding payments to and collections from CMs.

<u>Proposed Transition Process</u>

On the transition date, ICEU proposes to begin using the new rates for calculation of price alignment amounts. CDS denominated in EUR will stop using EONIA and will start using €STR, and CDS denominated in USD will stop using EFFR and will start using SOFR. The target transition date at the time of this filing is Monday, June 14, 2021, but may be delayed by ICEU. Any revised transition date will fall on a Monday to maintain the proposed operational process and will be publicized by ICEU. The €STR and SOFR rates available on Monday, June 14, 2021 will be applied to CDS Notional Margin Balances of Friday, June 11, 2021 for the determination of the first day of price alignment amounts using the new rates.

In connection with the transition of the rates, ICEU proposes to calculate one-time adjustment amounts and pay or collect, as appropriate, such amounts to or from CMs to account for the reasonably expected valuation changes associated with the use of the new interest rates. In calculating the adjustment amounts, ICEU will use the following methodology that has been subject to substantial discussion and feedback from market participants.

<u>One-Time Adjustment Methodology</u>

The proposed one-time adjustment methodology is set out as follows:

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[2] Additional information on the working group and the transition to €STR is available at: https://www.ecb.europa.eu/paym/interest_rate_benchmarks/WG_euro_risk-free_rates/html/index.en.html.

[3] <u>Id.</u>

[4] Additional information on the ARRC and transition to SOFR is available at: https://www.newyorkfed.org/arrc.

[5] <u>Id.</u>

- ICEU will obtain implied hazard term structures by using the end-of-day ("EOD") settlement values and the near EOD discount rate term structure for the rate being replaced (EFFR for USD denominated and EONIA for EUR denominated products) in the ISDA CDS standard model (fair value).
- For single name Contracts, the EOD prices of the nine benchmark tenors will be used to create the corresponding implied hazard rate term structure. Standard industry recovery rates will also be used except for distressed names where the standard recovery rate cannot result in a consistent hazard rate term structure. In such case, a recovery rate will be used that is close to the standard recovery rate that can result in a consistent hazard rate term structure.
- For index Contracts, the implied hazard rates for the tenors available for clearing will be used to create an implied hazard rate term structure. Based on feedback requesting that ICEU include the 3-year tenor of iTraxx Crossover and CDX High Yield index in determining the hazard rate term structure, ICEU has been collecting daily prices for these instruments even though they are not clearing eligible. ICEU will review the reasonability of the price collection with its CDS Product Risk Committee near the transition date to determine whether to use these tenors in determining the hazard term structures for iTraxx Crossover and CDX High Yield indexes.
- ICEU will calculate an adjusted EOD valuation using the implied hazard rate term structure and the replacement discount rate term structure (e.g., SOFR for USD and €STR for EUR denominated products).
- The EOD valuation less the adjusted EOD valuation will be the adjustment amount.
- EOD London snapshots of EONIA and €STER interest rate curves and EOD New York snapshots of EFFR and SOFR interest rate curves published by ICE Data Services will be used for the discount rate term structures [6].

<u>Operational Process</u>

ICEU has defined the operational process for the one-time adjustment payments and corresponding collections. ICEU will include the ad-hoc adjustments in CM EOD processing on Monday, June 14, 2021, which will be netted with other cash payments to determine Monday, June 14, 2021 EOD CM margin calls to be paid Tuesday, June 15, 2021. ICEU will provide CMs and clients with position level adjustment details after EOD Friday, June 11, 2021 and prior to Monday, June 14, 2021. ICEU will allow CMs to allocate adjustments at the level of individual house or client accounts. The proposed approach is intended to enable clients to reconcile adjustments they may receive from their CMs. Further, ICEU will provide CMs and clients the opportunity to review and consume relevant files as part of pre-transition simulations. One simulation was completed for March 26, 2021, and ICEU plans to hold future simulations closer to the transition date.

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6 The proposed methodology, which has been subject to substantial discussion and feedback from market participants, has also been coordinated with ICE Clear Credit LLC ("ICE Clear Credit"). Based on feedback that the clearing houses should seek to achieve congruent adjustment amounts for positions at ICEU and ICE Clear Credit, EOD valuations for North American products will be taken from ICE Clear Credit's EOD process during its North American pricing window.

Market Participant Engagement and Outreach

The proposed transition has been discussed and coordinated by ICEU with market participants, as well as with ICE Clear Credit, to achieve an orderly and efficient transition to the new rates. ICEU has sought feedback from and engaged with market participants to determine the proposed approach throughout 2020 and 2021, including through the CDS Product Risk Committee and the ISDA Credit Steering Committee. In relation to CDS valuations, feedback has indicated a desire for one-time adjustment payments to account for the reasonably expected valuation changes associated with the use of the new interest rates. The proposed one-time adjustment methodology, among other details, has been subject to substantial discussion and feedback from market participants.

As discussed below, ICEU has issued a public Consultation on the proposed approach on April 8, 2021 via a circular[7] and made available on its website further details on the proposed transition[8].

Compliance with the Act and CFTC Regulations

The amendments to the Delivery Procedures are potentially relevant to the following core principles: (D) Risk Management, (I) System Safeguards and (L) Public Information, and the applicable regulations of the Commission thereunder.

- *Risk Management*. The transition is consistent with the risk management requirements of Core Principle D. The proposed changes relate to the transition of the interest rates used for computing price alignment amounts and are in response to requests by industry participants in connection with the broader transition in the derivatives markets to the use of SOFR and €STR in lieu of existing interest rate benchmarks. The transition would include one-time adjustment payments to be made to or from CMs to account for the reasonably expected valuation changes associated with the use of the new rates. The transition has been discussed and coordinated by ICEU with market participants to achieve an orderly and efficient transition to the new rates. In ICEU's view, the proposed approach reduces uncertainty in respect of the transition and the potential impact of the interest rate benchmark reforms and reduces the potential for market disruption given the industry outreach and operational testing done by ICEU. ICEU will continue to ensure that it possesses the ability to manage the risks associated with discharging its responsibilities, consistent with the risk management requirements of Core Principle D.

- *System Safeguards*. The transition is consistent with the system safeguards requirements of Core Principle I. ICEU has defined the operational process and

[7] ICEU Circular 2021/055 on the Proposed change to Mark-to-Market Margin Interest Rates, dated April 8, 2021, is available at: https://www.theice.com/publicdocs/clear_europe/circulars/C21055.pdf.

[8] A detailed presentation on the proposed transition is in the presentation located here: https://www.theice.com/publicdocs/ice/notifications/adhoc/110000348161/ICE_CDS_Clearing_PriceAlignmentTransition_20210324_v1.3_final.pdf

considerations for the proposed transition, including the one-time adjustment payments, and has planned for pre-transition simulations to promote preparedness among itself and market participants. Such actions enhance ICEU's ability to identify and minimize sources of operational risk in respect of the proposed transition. ICEU believes that the transition is appropriately designed to reduce operational complexity and sufficiently coordinated among ICEU and market participants to achieve an orderly and efficient transition to the new rates.

- *Public Information.* The transition is consistent with the public information requirements of Core Principle L. ICEU has made its proposed approach publicly available on its website and issued a circular on the transition, including the one-time adjustment methodology, associated operational process, and pre-transition simulations. ICEU believes that it has provided market participants with sufficient information to identify and evaluate any risks and costs associated with the transition.

The proposed changes are designed to transition the interest rates used for computing CDS Price Alignment Amounts and include one-time adjustment payments to account for the reasonably expected valuation changes associated with the use of the new interest rates. Such changes do not require any revisions to the ICEU Rules or other written policies and procedures.

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

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

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

If you or your staff should have any questions or comments or require further information regarding this submission, please do not hesitate to contact the undersigned at giulia.honorati@ice.com or +44 20 7429 7127.

Very truly yours,

Giulia Honorati

Giulia Honorati
Compliance and Regulation, Manager