

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-74579; File No. SR-ICEEU-2015-007)

March 25, 2015

Self-Regulatory Organizations; ICE Clear Europe Limited; Notice of Filing of Proposed Rule Change Relating to Collateral and Haircut Policy

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder<sup>2</sup> notice is hereby given that on March 13, 2015, ICE Clear Europe Limited (“ICE Clear Europe” or “Clearing House”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared primarily by ICE Clear Europe. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

The principal purpose of the proposed rule change is to implement a new collateral and haircut policy (the “Haircut Policy”), which is applicable to Permitted Cover posted by Clearing Members to meet the Clearing House’s Margin and Guaranty Fund requirements.

II. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, ICE Clear Europe included statements concerning the purpose of and basis for the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. ICE Clear Europe has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The Haircut Policy codifies and consolidates certain existing practices of the Clearing House with respect to Permitted Cover. Specifically, the policy is designed (i) to set out overall principles with respect to the assets accepted by the Clearing House as Permitted Cover; (ii) to establish a framework for determining absolute and relative limits, as applicable, on the value of the collateral that may be posted by a Clearing Member as Permitted Cover; (iii) to establish a value-at-risk ("VaR") based methodology for determining haircuts for all Permitted Cover; (iv) to mitigate wrong-way risk from Permitted Cover; (v) to address sources for pricing Permitted Cover; and (vi) to set out certain related monitoring, reviewing and reporting procedures. The Haircut Policy applies to Permitted Cover provided for all product classes (F&O, CDS and FX).<sup>3</sup> Following implementation, the Clearing House will from time to time adjust the haircuts applicable to Permitted Cover under the methodology set forth in the policy.

The general aims of the Haircut Policy are to ensure that the Clearing House can efficiently liquidate all forms of Permitted Cover, that appropriate prices are used for valuation of Permitted Cover and that appropriate haircuts (including, as applicable, cross-currency haircuts) are used. The Haircut Policy also codifies certain general principles considered by the Clearing House in accepting assets as Permitted Cover, including availability of pricing information, the existence of liquid and active markets for buyers and sellers of those assets, the existence of sufficient price history, the ability to liquidate Permitted Cover without causing a

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<sup>3</sup> Although the Haircut Policy generally also applies to Permitted Cover posted with respect to Guaranty Fund requirements, certain additional requirements apply to Guaranty Fund contributions under the Rules and Finance Procedures. Those additional requirements are not proposed to be changed in connection with the Haircut Policy.

market disruption, compliance with legal and regulatory requirements and sufficient operational and technological framework to handle deposit, liquidation and return of such assets as Permitted Cover. Cash collateral must be in one of several specified currencies underlying contracts cleared by the Clearing House. Additional general requirements apply to financial instruments, including prohibitions on acceptance of instruments that have non-“vanilla” features such as embedded options, instruments issued by a Clearing Member or its affiliate, instruments issued by a CCP or by entities that provide critical services to the Clearing House (other than central banks) and certain credit-based limits. Such limits require that the issuer is rated at least “BBB-” by S&P (or its equivalent), the average yield on the asset over the previous three months is not greater than 8%, and the 5-year CDS spread of the issuer has not exceeded 500 basis points over the previous three months. The Haircut Policy provides that where market conditions warrant, or where the Clearing House’s sovereign risk model indicates deteriorating credit below a certain threshold (i.e., “BBB-” by S&P), the Clearing House may remove securities from the list of Permitted Cover and/or vary applicable haircuts. The Clearing House will notify Clearing Members and other market participants of such actions by Circular. The Clearing House maintains the current List of Permitted Cover (along with haircut rates, limits and restrictions) on its website, [https://www.theice.com/publicdocs/clear\\_europe/list-of-permitted-covers.pdf](https://www.theice.com/publicdocs/clear_europe/list-of-permitted-covers.pdf).

The Haircut Policy contains a methodology for setting absolute limits on the value of non-cash Permitted Cover that can be posted by a Clearing Member. (The Clearing House does not, however, impose absolute or relative limits on the use of US Treasury securities as Permitted Cover.) Absolute collateral limits apply across a group of affiliated Clearing Members and apply across all product categories cleared by that group. Collateral provided by Sponsored Principals with the same sponsoring member will be included in all collateral limit calculations

as part of the sponsoring member's client account. The policy also sets out relative, or concentration, limits for Permitted Cover provided by a Clearing Member. The Clearing House publishes on its website the current absolute and relative limits on government bonds provided as Permitted Cover. For government bonds, the absolute limit generally is calculated pursuant to a formula based on data from the repo market for the relevant government bond, taking into account both the overall size of that market and the percentage of that market consisting of repos with a one day maturity. The policy also specifies relevant sources of repo market data for particular types of government securities (including most European government bonds and Japanese government bonds accepted by the Clearing House) and gold market data for gold Permitted Cover. The policy also sets out alternative approaches for determining the limit for certain government bonds, including for UK, Swiss and Canadian government bonds. The policy sets out procedures for monitoring of limits on a daily basis and for remediation of breach of a limit by a Clearing Member. The risk management department monitors all collateral limits on a daily basis using a collateral breakdown report which flags limit breaches. Breaches will be reviewed internally and the relevant Clearing Member will be contacted. Breaches can be remediated by posting additional collateral, removal of collateral that is in breach of a limit, or both of the above.

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

mitigate wrong-way risk from government bond Permitted Cover. The specified parameters will be reviewed on a quarterly basis.

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

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

The Haircut Policy establishes a VaR-based methodology for determining haircuts for Permitted Cover. The Clearing House calculates six different estimations of VaR for each applicable risk factor. Two estimations are based on a historical simulation approach (using a 1,000-business day (approximately 4 year) lookback period), and a one-day or two-day liquidation period assumption. Four estimations are based on a parametric methodology: two using a 1,000-business day lookback period and a one-day or two-day liquidation period assumption, and two using a 60-business day (approximately 3 month) lookback period and a one-day or two-day liquidation period assumption. Each estimation is calculated using a 99.9%

confidence interval (applicable to Permitted Cover posted with respect to all product categories). The proposed haircut will be based on the largest VaR of the 6 estimations. Fixed income assets are divided into separate maturity buckets for each issuer, with a separate haircut established for each bucket. The policy specifies relevant price sources that will be used for the calculation of haircuts for each type of Permitted Cover. Haircuts are determined using the bid prices of Permitted Cover assets, in order to account for higher liquidation costs in stressed markets. The model output is rounded up to the nearest 0.25%, in order to limit unnecessary variation in haircut levels. The applicable haircuts will be reviewed on a monthly basis, or more frequently where the risk management department deems it necessary.

The risk management department may further adjust the haircut determined under the model as it determines prudent in light of additional qualitative and quantitative factors. These include the Clearing House's credit assessment of the issuer, current market conditions and volatility, expected future volatility, the liquidity of the underlying market for the asset, including bid/ask spread, wrong way risk considerations, VaR estimates determined for a period of stressed market conditions, and other factors that might affect the liquidity or value of an asset in stressed market conditions. The Clearing House anticipates that such adjustments to the value calculated under the model would be used only in exceptional circumstances and would expect to use such adjustments to increase haircuts in stressed market circumstances. The Clearing House will make judicious use of current market information to override the model but anticipates exercising this ability in less than 5% of haircut rates.

The Haircut Policy also sets a minimum haircut level of 3%, in order to avoid pro-cyclical variation in haircuts. (The minimum level will be reviewed annually under the Haircut Policy.) In addition, a haircut add-on of up to 1% will be applied during the period until the next

monthly review to issuers presenting increased credit risk. The add-on is applied once the issuer's CDS spread exceeds a specified level, and increases in steps of 0.25% up to a maximum of 1% where the CDS spread exceeds higher thresholds. The add-on is generally designed to anticipate potential haircut increases as part of the next monthly review cycle.

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

Haircuts are reviewed under the policy on at least a monthly basis, although the risk department may do so more frequently in exceptional circumstances. The Clearing House monitors Permitted Cover on a daily and intraday basis. The Clearing House may, under its existing Rules and the Haircut Policy, take action to mitigate any change in risk, including by increasing haircuts, calling for additional collateral, reducing concentration limits and removing an asset from eligibility as Permitted Cover. The Clearing House monitors the value of Permitted Cover deposited with it on a real time basis. Any change in a member's intra-day cover value that is greater than 3% is flagged immediately by the Risk Management intraday monitoring system that is monitored by the Risk Management team throughout the business day. Any breach is investigated and appropriate action taken where necessary. The Clearing House also will backtest haircuts based on price moves observed in the markets on a daily basis, and review haircut levels if a price move breaches an existing haircut. The Clearing House prepares daily reports with respect to Permitted Cover for purposes of internal monitoring and provides

monthly reports to the relevant Risk Committees and Board Risk Committee. The Clearing House will review the Haircut Policy on an annual basis (which will include review by the Board Risk Committee) or where there is a material change to the risk exposure of the Clearing House. The Haircut Policy will also be independently reviewed annually under the Clearing House's model governance framework.

## 2. Statutory Basis

ICE Clear Europe believes that the proposed rule change is consistent with the requirements of Section 17A of the Act<sup>4</sup> and the regulations thereunder applicable to it.<sup>5</sup> Section 17A(b)(3)(F) of the Act<sup>6</sup> requires, among other things, that the rules of a clearing agency be designed to promote the prompt and accurate clearance and settlement of securities transactions and, to the extent applicable, derivative agreements, contracts, and transactions, the safeguarding of securities and funds in the custody or control of the clearing agency, and the protection of investors and the public interest. ICE Clear Europe is adopting the Haircut Policy to codify and consolidate its procedures and practices concerning the determination of haircuts and certain other limitations applicable to Permitted Cover provided in respect of initial and original margin requirements. These limitations include establishment of general principles for the assets accepted as Permitted Cover, valuation of Permitted Cover, absolute and relative concentration limits on the amount of a particular bond a Clearing Member (including any affiliated Clearing Members) may provide as Permitted Cover as well as further measures designed to mitigate wrong-way-risk. ICE Clear Europe believes that the policy provides a conservative set of haircuts intended to protect the Clearing House from a decline in collateral value or a change in

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<sup>4</sup> 15 U.S.C. 78q-1.

<sup>5</sup> 17 CFR 240.17Ad-22.

<sup>6</sup> 15 U.S.C. 78q-1(b)(3)(F).



exchange rates in circumstances where it is required to liquidate Permitted Cover following a Clearing Member default. In addition, the policy permits the Clearing House to respond promptly and appropriately to changes in market conditions by modifying haircuts or other limits on Permitted Cover. ICE Clear Europe thus believes that the Haircut Policy will enhance the stability of the clearing system and the Clearing House's ability to manage a Clearing Member default and to continue to fulfill its obligations in a Clearing Member default scenario. As a result, in ICE Clear Europe's view, the proposed changes will facilitate the prompt and accurate settlement of such transactions, assure the safeguarding of securities and funds which are in the custody or control of ICE Clear Europe or for which it is responsible, and promote the public interest and the protection of investors, within the meaning of Section 17A(b)(3)(F).<sup>7</sup>

B. Self-Regulatory Organization's Statement on Burden on Competition

ICE Clear Europe does not believe the amendments would have any impact, or impose any burden, on competition not necessary or appropriate in furtherance of the purposes of the Act. The Haircut Policy will be applicable to all Clearing Members with respect to assets provided by those members as Permitted Cover. ICE Clear Europe does not believe the adoption of the policy will adversely affect competition among Clearing Members. Furthermore, ICE Clear Europe does not anticipate that the changes will adversely affect the ability of market participants to clear contracts generally, reduce access to clearing generally, or limit market participants' choices for clearing such contracts. Although it is possible that the application of the Haircut Policy will result in higher haircuts or lower limitations for certain categories of Permitted Cover, ICE Clear Europe believes that the policy appropriately tailors the haircuts and limitations to the particular market, liquidity and credit risks presented by particular assets as

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<sup>7</sup> 15 U.S.C. 78q-1(b)(3)(F).

Permitted Cover. As a result, in ICE Clear Europe's view, any incremental increase in cost of using certain types of Permitted Cover is warranted in light of the risks presented to the Clearing House. ICE Clear Europe thus believes that any impact on competition from the new model is appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others

Written comments relating to the proposed rule change have not been solicited or received. ICE Clear Europe will notify the Commission of any written comments received by ICE Clear Europe.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period up to 90 days (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve or disapprove the proposed rule change or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>) or

- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-ICEEU-2015-007 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-ICEEU-2015-007. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filings will also be available for inspection and copying at the principal office of ICE Clear Europe and on ICE Clear Europe's website at <https://www.theice.com/clear-europe/regulation>.

All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-ICEEU-2015-007 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>8</sup>

Brent J. Fields  
Secretary

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<sup>8</sup> 17 CFR 200.30-3(a)(12).