<u>Capitalisation of exposures to Central Counterparties</u>

ICE welcomes the opportunity to respond to the Basel Committee on the consultative document entitled Capitalisation of exposures to Central Counterparties.

ICE's clearing operations comprise the following CCPs across the U.S., Europe and Canada:

- ICE Clear Europe is recognised by the U.K. Financial Services Authority (FSA) and is the designated clearing house for ICE Futures Europe, ICE OTC and European credit default swap (CDS) contracts. ICE Clear Europe is also a CFTC-regulated Derivatives Clearing Organization (DCO) and SEC-regulated Securities Clearing Agency (SCA).
- ICE Clear U.S. operates as a registered Derivatives Clearing Organization (DCO) under the oversight of the U.S. Commodity Futures Trading Commission (CFTC) and is the designated clearing house for ICE Futures U.S.
- ICE Clear Canada is regulated by the Manitoba Securities Commission (MSC) and is the designated clearing house for ICE Futures Canada.
- ICE Clear Credit is a clearing house for North American credit default swap (CDS) markets. ICE Clear Credit is a CFTC-regulated Derivatives Clearing Organization (DCO) and SEC-regulated Securities Clearing Agency (SCA).

Our comments are summarised below:

1. ICE welcomes the approach taken by the committee to appropriately capitalise each bank's exposure to CCPs and at create incentives for banks to increase their use of CCPs, and in so doing reduce systemic risk. It is noted that the appropriate capitalisation regime when viewed solely from the point of view of an individual bank's risks, in isolation, may differ from the optimal treatment taking into account systemic risk more generally, and the incentives created by capital weightings.

2. We also agree with the point made in the consultative document concerning the importance of CCPs being subject to best-practice risk management. We welcome in this regard the distinction between the capital treatment of exposures to CCPs which adhere to the CPSS-IOSCO principles compared to those which do not adhere to these principles. Indeed, we believe that the adherence to CPSS-IOSCO principles should be employed more broadly as a test of a CCP risk management processes, as described in paragraph 5 below. We have submitted a number of comments during the initial consultative process for these principles, and await the latest draft. We have also expressed the importance of the provisions contained within EMIR being consistent with these CPSS-IOSCO principles.

3. We appreciate the consideration given to the calculation methodology for the risk weighting related to clearing members' default fund contributions. It is important that this risk weighting is set at a level which properly reflects each individual bank's risks exposure and at the same time incentivises the proper balance between initial margins and guarantee fund contributions. In this regard we are very concerned about the method of calculation of the exposure value – namely the "Current

Exposure Method" (CEM). This approach is very simplistic and not suited for use for CCPs. Most importantly, the method makes use of **notional values**, which do not form an appropriate basis for the measurement of risk for CCP cleared trades. In additional there are issues relating to netting, add-on percentages and the form of the summation which we do not believe represent properly CCP risks. The consequence of this, given the relatively high notional values of many CCP cleared trades, is that guarantee fund contributions will be calculated at extremely high levels. We do not believe that this reflects individual banks' risks appropriately. Furthermore, a model of high initial margin levels and low guarantee fund contributions should not in our view be given favourable capital treatment over a model of lower initial margin levels and higher guarantee fund contributions.

4. We welcome the simplification of the treatment of unfunded guarantee fund contributions, and note that both funded guarantee fund contributions and unfunded guarantee fund contributions (arising for example from a CCP's powers of assessment) are treated equally. This of course amplifies the importance of ensuring the proper weighting of guarantee fund contributions, as set out in paragraph 3 above.

5. Paragraph 111 of the consultative report proposes that a clearing member should always capitalise its exposure to clients as bilateral trades, irrespective of whether the trades are cleared through CCPs. Given that a clearing member's contribution to the guarantee fund of a CCP is generally determined in proportion to its open interest, this treatment places clearing members' trades for clients through a CCP at a disadvantage compared to bilateral trades. This is appropriate neither from the point of view of calibration of a bank's exposures nor from the point of view of incentivising the increased use of CCPs.

6. The treatment of client exposures set out in paragraph 112 of the consultative report places an onerous and cumbersome responsibility on clients to ensure no possibility of loss in the event of insolvency of the clearing member or its clients, and the portability of positions and collateral. In particular each client must be in a position to deliver an 'independent, written and reasoned legal opinion' that concludes that there would be no effective legal challenge to the arrangements. This is an extremely high level of proof, out of proportion to the level of confidence required in any other aspect of clearing arrangements. We believe that such a high level of proof is inappropriate and extremely cumbersome, and instead beneficial capital weighting should be linked to a CCP's adherence to CPSS-IOSCO principles.

7. The proposals set out in paragraph 112 would also discourage the use of title transfer collateral arrangements and encourage the use of security interests collateral arrangements. This would be disruptive in financial markets that are accustomed to using title transfer collateral arrangements, such as the EU.

8. Whilst we welcome the 0% capital weighting proposed for collateral that is held at a custodian in a bankruptcy remote manner, we nevertheless would make the following points:

a. If the Committee's focus is on counterparty credit risk, then it should permit alternative methods by which that risk can be mitigated and not only prescribe one manner of risk mitigation (i.e. placement of collateral with a bankruptcy remote custodian)

b. There are a number of legal uncertainties associated with the use of bankruptcy remote custodians not taken into account.

c. As discussed in point 7 above, the reference to bankruptcy remoteness is incompatible with the use of title transfer collateral arrangements as used in the EU.

We would be happy to discuss these points further, or provide further detail as requested.