

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-82890; File No. SR-ICEEU-2018-002)

March 16, 2018

Self-Regulatory Organizations; ICE Clear Europe Limited; Order Granting Accelerated Approval of Proposed Rule Change Relating to the ICE Clear Europe Limited CDS Procedures, CDS Risk Policy, and CDS Risk Model Description

I. Introduction

On February 6, 2018 ICE Clear Europe Limited (“ICE Clear Europe”) filed with the Securities and Exchange Commission (“Commission”), 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> a proposed rule change (SR-ICEEU-2018-002) to revise: (i) its CDS Procedures to support the clearing of a new transaction type; and (ii) its CDS Risk Policy, and CDS Risk Model Description document to incorporate certain modifications to its risk management methodology.<sup>3</sup> The proposed rule change was published for comment in the Federal Register on February 15, 2018.<sup>4</sup> The Commission did not receive comments on the proposed rule change. For the reasons discussed below, the Commission is approving the proposed rule change on an accelerated basis.

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

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

<sup>3</sup> Capitalized terms used in this order, but not defined herein, have the same meaning as in the ICE Clear Europe Rules, CDS Procedures, CDS Risk Policy, or CDS Risk Model Description.

<sup>4</sup> Securities Exchange Act Release No. 34-82678 (February 9, 2018), 83 FR 6909 (February 15, 2018) (SR-ICEEU-2018-002) (“Notice”).

## II. Description of the Proposed Rule Change

ICE Clear Europe proposed revisions to its CDS Procedures, CDS Risk Policy, and Risk Model Description document in order to provide for the clearing of a new transaction type, the Standard European Senior Non-Preferred Financial Corporate, and to provide for revised risk management practices.

### A. Changes to ICE Clear Europe CDS Procedures

ICE Clear Europe proposed amending Paragraph 4.3(c)(ii) of its CDS Procedures, which sets forth the requirements for Trade Particulars for CDS that are submitted for Clearing, to reference the Standard European Senior Non-Preferred Financial Corporate transaction type.<sup>5</sup>

ICE Clear Europe also proposed amending Paragraph 11.3(i) to revise the definition of “Non-STEC Single Name Contract” to include the Standard European Senior Non-Preferred Financial Corporate transaction type in the list of Reference Entities eligible to be cleared by ICE Clear Europe, and also proposed amending Paragraph 11.3(j) to remove a requirement providing that the relevant obligation must be “Senior Level” and replace it with a requirement that the relevant obligation be of the “applicable seniority level.”<sup>6</sup>

### B. Changes to ICE Clear Europe’s Risk Model Description

As currently constructed, ICE Clear Europe’s risk management methodology takes into consideration the potential losses associated with idiosyncratic credit events, which ICE Clear Europe refers to as “Loss-Given Default” or “LGD.” ICE Clear Europe

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<sup>5</sup> Notice, 83 FR at 6909.

<sup>6</sup> Id. at 6909-10.

deems each Single Name (“SN”) reference entity a Risk Factor, and each combination of definition, doc-clause, tier, and currency for a given SN Risk Factor as a SN Risk Sub-Factor. ICE Clear Europe currently measures losses associated with credit events through a stress-based approach incorporating three recovery rate scenarios: a minimum recovery rate, an expected recovery rate, and maximum recovery rate. ICE Clear Europe combines exposures for Outright and index-derived Risk Sub-Factors at each recovery rate scenario.<sup>7</sup>

ICE Clear Europe currently uses the results from the recovery rate scenarios as an input into the Profit/Loss-Given-Default (“P/LGD”) calculations at both the Risk Sub-Factor and Risk Factor levels. For each Risk Sub-Factor, ICE Clear Europe calculates the P/LGD as the worst credit event outcome, and for each Risk Factor, ICE Clear Europe calculates the P/LGD as the sum of the worst credit outcomes per Risk Sub-Factor. These final P/LGD results are used as part of the determination of risk requirements.<sup>8</sup>

ICE Clear Europe proposed changes to its LGD framework at the Risk Factor level with respect to the LGD calculation. Specifically, ICE Clear Europe proposed a change to its approach by incorporating more consistency in the calculation of the P/LGD by using the same recovery rate scenarios applied to the different Risk Sub-Factors which are part of the considered Risk Factor. For each Risk Factor, ICE Clear Europe would continue to calculate an “extreme outcome” as the sum of the worst Risk Sub-Factor P/LGDs across all scenarios and also would, for each Risk Factor, calculate an “expected

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<sup>7</sup> Id. at 6910.

<sup>8</sup> Id.

outcome” as the worst sum of all the Risk Sub-Factors P/LGDs across all of the same scenarios. Under the proposed changes, ICE Clear Europe would then combine the results of the “extreme outcome” calculation and the “expected outcome” calculation to compute the total LGD for each Risk Factor.<sup>9</sup> ICE Clear Europe proposed to apply a weight of 25% to the extreme outcome component in order to implement certain requirements of relevant regulatory technical standards arising under the European Market Infrastructure Regulation.<sup>10</sup>

ICE Clear Europe also proposed to expand its LGD analysis to incorporate a new “Risk Factor Group” level. Under the proposed changes, a set of related Risk Factors would form a Risk Factor Group based on either (1) having a common majority parental sovereign ownership (e.g. quasi-sovereigns and sovereigns), or (2) being a majority owned subsidiary of a common parent entity according to the Bloomberg Related Securities Analysis. ICE Clear Europe noted that a Risk Factor Group could consist of only one Risk Factor.<sup>11</sup>

Under the proposed revisions, ICE Clear Europe would calculate the total quantity LGD on a Risk Factor Group level, and account for the exposure due to credit events associated with the reference entities within a given Risk Factor Group. Where a Risk Factor Group contains only one Risk Factor, ICE Clear Europe would compute the LGD

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<sup>9</sup> Id.

<sup>10</sup> See Commission Delegated Regulation (EU) No 153/2013 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. ICE Clear Europe is authorized as a central counterparty under the European Market Infrastructure Regulation and is subject to the requirements thereof.

<sup>11</sup> Notice, 83 FR at 6910.

as the risk exposure due to a credit event for a given underlying reference entity. Moreover, under the proposed approach, ICE Clear Europe would sum the P/LGDs for each Risk Factor in a given Risk Factor Group, with limited offsets in the event the Risk Factors exhibit positive P/LGD. Using the results of the above calculation, ICE Clear Europe would obtain the Risk Factor Group level LGD. The proposed approach would also include a calculation which allows for the Risk Factor Group level LGD to be attributed to each Risk Factor within the considered Risk Factor Group.<sup>12</sup>

In addition to these changes, ICE Clear Europe also proposed changes to the “Loss Given Default Risk Analysis” section of its Risk Model Description document to incorporate the Risk Factor and Risk Factor Group LGD calculation changes described above, as well as to incorporate certain conforming changes to other sections of the Risk Model Description document to reflect the proposed Risk Factor Group analysis.<sup>13</sup>

ICE Clear Europe also proposed further changes with respect to the “Idiosyncratic Jump-to-Default Requirements” section of the Risk Model Description document. As currently constructed, the portfolio jump-to-default approach collateralizes the worst uncollateralized LGD (“ULGD”) exposure among all Risk Factors. Under the proposed changes, the portfolio jump-to-default (“JTD”) approach would collateralize, through the portfolio JTD initial margin requirement that accounts for the Risk Factor Group-specific LGD collateralization, the worst ULGD exposure among all Risk Factor Groups. The

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<sup>12</sup> Id.

<sup>13</sup> Id.

ULGD exposure for a given Risk Factor Group would be calculated as a sum of the associated Risk Factor ULGDs.<sup>14</sup>

ICE Clear Europe also proposed certain minor edits to the Specific Wrong-Way Risk and General Wrong Way Risk sections of the Risk Model Description document to update language and calculation descriptions to accommodate the introduction of the Risk Factor Group to the “Idiosyncratic Jump-to-Default Requirements” section.<sup>15</sup>

In addition, ICE Clear Europe proposed changes to the “Guaranty Fund Methodology” section of the Risk Model Description document. ICE Clear Europe’s current guaranty fund methodology includes, among other things, the assumption that up to three credit events, different from the ones associated with Clearing Members, occur during the considered risk horizon. ICE Clear Europe proposed expanding this approach to the Risk Factor Group level by assuming that credit events associated with up to three Risk Factor Groups, different from the ones associated with the Clearing Members and the Risk Factors that are in the Risk Factor Groups as the Clearing Participants, occur during the considered risk horizon.<sup>16</sup>

Additional amendments to ICE Clear Europe’s Risk Model Description document include minor typographical and technical corrections and clarifications.<sup>17</sup>

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<sup>14</sup> Id.

<sup>15</sup> Id.

<sup>16</sup> Id.

<sup>17</sup> Id. at 6911.

### C. Changes to ICE Clear Europe's CDS Risk Policy

ICE Clear Europe proposed conforming edits to its CDS Risk Policy in order to incorporate the changes described above. Specifically, ICE Clear Europe proposed to amend the definition of Risk Sub-Factor, as set forth in the CDS Risk Policy, so that it is defined as a particular combination of single-name reference, tier, currency, and documentation clause.<sup>18</sup> In addition, ICE Clear Europe proposed to amend the CDS Risk Policy to provide that the worst LGD associated with a Risk Factor Group will be used to determine the JTD requirement, instead of the worst single-name LGD, and also proposed amendments that would clarify that a Risk Factor Group would consist of a set of Risk Factors related by a common parental ownership.<sup>19</sup>

### III. Discussion and Commission Findings

Section 19(b)(2)(C) of the Act directs the Commission to approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to such organization.<sup>20</sup> For the reasons given below, the Commission finds that the proposal is consistent with Section 17A(b)(3)(F) of the Act, and Rules 17Ad-22(b)(2), (b)(3), (e)(4)(ii), and (e)(6)(i).

#### A. Consistency with Section 17A(b)(3)(F) of the Act

Section 17A(b)(3)(F) of the Act requires, among other things, that the rules of a registered clearing agency be designed to promote the prompt and accurate clearance and

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<sup>18</sup> Id.

<sup>19</sup> Id.

<sup>20</sup> 15 U.S.C. 78s(b)(2)(C).

settlement of securities transactions and, to the extent applicable, derivative agreements, contracts, and transactions, to assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible and, in general, to protect investors and the public interest.<sup>21</sup> The proposed rule change will provide for the clearance and settlement of the Standard European Senior Non-Preferred Financial Corporate, a new type of transaction that is similar to contracts already cleared by ICE Clear Europe.

Separately, as described above, the proposed rule change would also provide for certain revisions to ICE Clear Europe's risk management methodology with respect to its LGD methodology. These changes entail (i) incorporating a more consistent approach with respect to ICE Clear Europe's recovery rate scenarios through the application of the same recovery rate scenarios to risk factors that form part of the same Risk Factor Group, (ii) combining the results of the "expected" and "extreme" P/LGD outcomes in order to calculate the total LGD for each Risk Factor, (iii) expanding ICE Clear Europe's LGD analysis to a new Risk Factor Group level, (iv) revising the calculation of the Uncollateralized Loss Given Default to incorporate the Risk Factor Group level LGD approach, and (v) modifying ICE Clear Europe's Guaranty Fund Methodology to expand the credit event analysis to include the Risk Factor Group approach.

Based on a review of the Notice, the Commission believes that the Standard European Senior Non-Preferred Financial Corporate transaction type is substantially similar to other contracts cleared by ICE Clear Europe. As such, the Commission believes that ICE Clear Europe's existing clearing arrangements, and related financial

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<sup>21</sup> 15 U.S.C. 78q-1(b)(3)(F).



safeguards (including as further modified by the proposed rule change), protections and risk management procedures will apply to this new product on a substantially similar basis to the other contracts currently cleared by ICE Clear Europe.

Moreover, the Commission believes that the proposed changes to ICE Clear Europe's risk management framework described above will enhance the manner by which ICE Clear Europe considers and manages the risks particular to the range of contracts it clears, including the new Standard European Senior Non-Preferred Financial Corporate contract, because such changes will enable ICE Clear Europe to more accurately consider the particular risks of each type of product it clears, including security-based swap products. Therefore, the Commission finds that the proposed rule change is intended to promote the prompt and accurate clearance and settlement of securities transactions and derivatives agreements, contracts, and transactions, as well as to assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible and, in general, to protect investors and the public interest, and is therefore consistent with Section 17A(b)(3)(F) of the Act.<sup>22</sup>

**B. Consistency with Rules 17Ad-22(b)(2) and (e)(6)(i)**

The Commission further finds that the proposed rule change is consistent with Rules 17Ad-22(b)(2) and (e)(6)(i). Rule 17Ad-22(b)(2) requires, in relevant part, a registered clearing agency that performs central counterparty services to establish, implement, maintain and enforce written policies and procedures reasonably designed to use margin requirements to limit the registered clearing agency's credit exposures to participants under normal market conditions and use risk-based models and parameters to

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<sup>22</sup>

Id.

set margin requirements.<sup>23</sup> Rule 17A-d22(e)(6)(i) requires, in relevant part, that a covered clearing agency that provides central counterparty services establish, implement, maintain and enforce written policies and procedures reasonably designed to cover its credit exposures to its participants by establishing a risk-based margin system that, at a minimum, considers, and produces margin levels commensurate with, the risks and particular attributes of each relevant product, portfolio, and market.<sup>24</sup>

As described above, the proposed changes would (i) amend the manner in which ICE Clear Europe calculates its Risk Factor-level LGD, (ii) expand the LGD analysis to the Risk Factor Group level, and (iii) amend the approach to calculating the Uncollateralized LGD to incorporate the Risk Factor Group level approach. Specifically, ICE Clear Europe would calculate, for each Risk Factor, an extreme outcome as the sum of the worst Risk Sub-factor P/LGDs across all scenarios, and an expected outcome as the worst sum of all Risk Sub-factor P/LGDs using the same scenarios, and then add the two components to determine the total LGD for each Risk Factor.

The LGD analysis would also be modified to group individual Risk Factors into Risk Factor Groups, and would result in the total LGD being the sum of the P/LGDs for each Risk Factor within the Risk Factor Group. The Commission believes that by making these changes, ICE Clear Europe will augment its ability to more accurately consider the risks associated with the products it clears, including the Standard European Senior Non-Preferred Financial Corporate transaction type.

As a result, the Commission believes that the proposed rule change will facilitate the establishment of a risk-based margin system that considers, and produces margin

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<sup>23</sup> 17 CFR 240.17Ad-22(b)(2).

<sup>24</sup> 17 CFR 240.17Ad-22(e)(6)(i).

levels commensurate with, the risks and particular attributes of the relevant product, portfolio, and market, and will also enable ICE Clear Europe to more accurately determine and collect the amount of resources necessary to limit its credit exposures under normal market conditions, including credit exposures resulting from clearing the new transaction type, through the use of risk-based models. Therefore the Commission finds that the proposed rule change is consistent with Rules 17Ad-22(b)(2) and (e)(6).<sup>25</sup>

C. Consistency with Rules 17Ad-22(b)(3) and (e)(4)(ii).

The Commission further finds that the proposed rule change is consistent with Rules 17Ad-22(b)(3) and (e)(4)(ii). Rule 17Ad-22(b)(3) requires, in relevant part, a registered clearing agency that performs central counterparty services to establish, implement, maintain and enforce written policies and procedures that are reasonably designed to maintain sufficient financial resources to withstand, at a minimum, a default by the two participant families to which it has the largest exposures in extreme but plausible market conditions.<sup>26</sup> Rule 17Ad-22(e)(4)(ii) requires, in relevant part, that a covered clearing agency establish, implement, maintain and enforce written policies and procedures reasonably designed to effectively identify, measure, monitor, and manage its credit exposures to participants and those arising from its payment, clearing, and settlement processes, including by, for covered clearing agencies that are clearing agencies involved in activities with a more complex risk profile, maintaining additional financial resources at the minimum to enable it to cover a wide range of foreseeable stress scenarios that include, but are not limited to, the default of the two participant

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<sup>25</sup> 17 CFR 240.17Ad-22(b)(2) and (e)(6)(i).

<sup>26</sup> 17 CFR 240.17Ad-22(b)(3).

families that would potentially cause the largest aggregate credit exposure for the covered clearing agency in extreme but plausible market conditions.<sup>27</sup>

As described above, the proposed rule change would amend certain assumptions in ICE Clear Europe's Guaranty Fund Methodology, and the calculation of the Specific Wrong Way Risk component of its guaranty fund, by incorporating the new Risk Factor Group level analysis. Specifically, ICE Clear Europe would expand its current approach to assume that credit events used in the guaranty fund analysis occur at the Risk Factor Group level, and would also base the specific wrong-way risk component of its Guaranty Fund Methodology on the Risk Factor Group approach.

As with the changes to the LGD approach, the Commission believes that the proposed changes to ICE Clear Europe's Guaranty Fund Methodology will permit ICE Clear Europe to more accurately consider the particular risks associated with the products it clears, including the Standard European Senior Non-Preferred Financial Corporate transaction type, that will be cleared as a result of the proposed changes to ICE Clear Europe's CDS Procedures described above. As a result, the Commission believes that the proposed changes will enable ICE Clear Europe to more accurately measure the risks of associated with the products it clears and thereby improve ICE Clear Europe's ability to collect and maintain the level of financial resources necessary to cover a wide range of foreseeable stress scenarios that include, but are not limited to, the default of the two participant families that would potentially cause the largest aggregate credit exposure

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<sup>27</sup> 17 CFR 240.17Ad-22(e)(4)(ii).

under extreme but plausible market conditions. Therefore, the Commission finds that the proposed rule change is consistent with Rules 17Ad-22(b)(3) and (e)(4)(ii).<sup>28</sup>

Section 19(b)(2)(C)(iii) of the Act allows the Commission to approve a proposed rule change earlier than 30 days after the date of publication of the notice of the proposed rule change where the Commission finds good cause for so doing and publishes the reason for the finding.<sup>29</sup> The Commission finds good cause, pursuant to Section 19(b)(2)(C)(iii) of the Act, for approving the proposed rule change on an accelerated basis prior to the 30<sup>th</sup> day after the date of publication of the notice in the Federal Register in order to facilitate the clearing of the Standard European Senior Non-Preferred Financial Corporate transaction type, which the Commission understands market participants will commence trading beginning on March 20, 2018<sup>30</sup> and which are tied to European capital and resolution regulations.

#### IV. Conclusion

On the basis of the foregoing, the Commission finds that the proposed rule change is consistent with the requirements of the Act and in particular with the requirements of Section 17A of the Act,<sup>31</sup> and Rules 17Ad-22(b)(2), (b)(3), (e)(4)(ii), and (e)(6)(i) thereunder.<sup>32</sup>

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<sup>28</sup> 17 CFR 240.17Ad-22(b)(3) and (e)(4)(ii).

<sup>29</sup> 15 U.S.C. 78s(b)(2)(C)(iii).

<sup>30</sup> See IHS Markit iTraxx Europe Rule Announcement, February 6, 2018 (stating that for iTraxx Europe Series 29, for French bank OpCos that qualify for inclusion in the index, the senior non-preferred reference obligations will be selected if available).

<sup>31</sup> 15 U.S.C. 78q-1.

<sup>32</sup> 17 CFR 240.17Ad-22(b)(2), (b)(3), (e)(4)(ii) and (e)(6)(i).

IT IS THEREFORE ORDERED pursuant to Section 19(b)(2) of the Act<sup>33</sup> that the proposed rule change (SR-ICEEU-2018-002) be, and hereby is, approved on an accelerated basis.<sup>34</sup>

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>35</sup>

Eduardo A. Aleman  
Assistant Secretary

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<sup>33</sup> 15 U.S.C. 78s(b)(2).

<sup>34</sup> In approving the proposed rule change, the Commission considered the proposal's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>35</sup> 17 CFR 200.30-3(a)(12).