

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-87971; File No. SR-ICC-2019-013)

January 15, 2020

Self-Regulatory Organizations; ICE Clear Credit LLC; Order Approving Proposed Rule Change Relating to the ICC Clearing Rules to Reflect the ISDA NTCE Supplement

I. Introduction

On November 15, 2019, ICE Clear Credit LLC (“ICE Clear Credit” or “ICC”) filed with the Securities and Exchange Commission pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934¹ and Rule 19b-4thereunder,² a proposed rule change to make certain changes to the ICC Clearing Rules (the “Rules”)³ to implement the 2019 Narrowly Tailored Credit Event Supplement to the 2014 ISDA Credit Derivatives Definitions (the “NTCE Supplement”) that are being adopted in the broader credit default swap (“CDS”) market to address so-called narrowly tailored credit events and related matters. The proposed rule change was published for comment in the Federal Register on December 2, 2019.⁴ The Commission did not receive comments on the proposed rule change.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Capitalized terms used but not defined herein have the meanings specified in the Rules.

⁴ Securities Exchange Act Release No. 87612 (November 25, 2019), 84 FR 66036 (Dec. 2, 2019) (SR-ICC-2019-013) (“Notice”).

II. Description of the Proposed Rule Change

A. Background

Following certain events in the CDS⁵ market, the International Swaps and Derivatives Association, Inc. (“ISDA”), in consultation with market participants, developed and published the NTCE Supplement.⁶ The NTCE Supplement reflects an effort by ISDA to address so-called narrowly-tailored credit events. According to ISDA, a narrowly-tailored credit event is an arrangement between a participant in the CDS marketplace and a corporation, through which the corporation triggers a credit event on CDS covering the corporation, thereby increasing payment to the buyers of CDS protection on the corporation while minimizing the impact on the corporation.⁷

The NTCE Supplement, if applied to a CDS transaction, would make two principal changes to the 2014 ISDA Credit Derivatives Definitions to address narrowly-tailored credit events.⁸ First, the NTCE Supplement would change the definition of the

⁵ The following description is substantially excerpted from the Notice. See Notice, FR at 66036.

⁶ See ISDA Board Statement on Narrowly Tailored Credit Events available at <https://www.isda.org/2018/04/11/isda-board-statement-on-narrowly-tailored-credit-events/>; see also Joint Statement on Opportunistic Strategies in the Credit Derivatives Market (“The continued pursuit of various opportunistic strategies in the credit derivatives markets, including but not limited to those that have been referred to as ‘manufactured credit events,’ may adversely affect the integrity, confidence and reputation of the credit derivatives markets, as well as markets more generally.”) available at <https://www.sec.gov/news/press-release/2019-106>.

⁷ See ISDA Board Statement on Narrowly Tailored Credit Events, available at <https://www.isda.org/2018/04/11/isda-board-statement-on-narrowly-tailored-credit-events/>.

⁸ See ISDA 2019 NTCE Protocol FAQ, available at <https://www.isda.org/protocol/isda-2019-ntce-protocol>.

“Failure to Pay” credit event to exclude certain narrowly tailored credit events through a new Credit Deterioration Requirement. The Credit Deterioration Requirement would provide that a failure of a corporation to make a payment on an obligation would not constitute a Failure to Pay Credit Event triggering CDS on that corporation if the failure does not directly or indirectly either result from, or result in, a deterioration in the creditworthiness or financial condition of the corporation.⁹ Thus, a narrowly tailored or manufactured failure to pay that does not reflect or result in a credit deterioration by a corporation would not constitute a Credit Event for CDS Contracts that incorporate the NTCE Supplement and thus would not necessarily trigger payment to buyers of CDS protection. The NTCE Supplement would also provide guidance related to the factors that would be relevant to determining whether the Credit Deterioration Requirement had been met, which determination would, under the 2014 Definitions, in the ordinary course be made by the relevant Credit Derivatives Determinations Committee.

Second, the NTCE Supplement would reduce the amount of payout a CDS protection buyer could claim in certain circumstances by imposing a new provision for Fallback Discounting. Fallback Discounting would discount a CDS protection buyer’s claim for payout under a CDS contract where that claim for payout is based on an obligation issued by a corporation at a discount.¹⁰ This would address the potential scenario where a corporation agrees to issue a bond at a substantial discount to its

⁹ See ISDA 2019 Narrowly Tailored Credit Event Supplement to the 2014 ISDA Credit Derivatives Definitions (Published on July 15, 2019), available at <https://www.isda.org/a/KDqME/Final-NTCE-Supplement.pdf>.

¹⁰ Id.

principal amount and the bond is delivered in settlement of a CDS at its full principal amount. In this scenario, Fallback Discounting would prevent a buyer of CDS protection from using the full principal amount of the bond issued at a discount as a basis for payout under the CDS contract.

B. Changes to the ICC Clearing Rules

Because ICC will clear and settle CDS contracts to which the NTCE Supplement will apply, it must ensure that its relevant Rules accurately reflect the changes described above that will be implemented by the NTCE Supplement. Accordingly, the proposed rule change would ensure that the changes being implemented by the NTCE Supplement are accurately reflected in its relevant Rules for both new and existing cleared transactions that incorporate the 2014 ISDA Credit Derivatives Definitions.¹¹ For this purpose, the proposed ICC amendments will apply to all cleared CDS contracts with corporate (i.e., non-sovereign) reference entities.¹²

Specifically, ICC would amend Rule 20-102 to include new definitions for (i) the “NTCE Supplement,” which would be the Narrowly Tailored Credit Event Supplement to the 2014 ISDA Credit Derivatives Definitions published by ISDA on July 15, 2019, (ii) “NTCE Amending Contracts,” which would be those Contracts being amended to incorporate the NTCE Supplement as specified in a list to be maintained by ICC, and (iii)

¹¹ Notice, 84 FR at 66037.

¹² Id.

the “NTCE Effective Date,” which will be January 27, 2020 (the date of implementation of the amendment), or such later date as designated by ICC by Circular.¹³

In addition, ICC would amend each relevant subchapter of Chapter 26 of the Rules to implement the NTCE Supplement and ensure that relevant contracts already being cleared and settled by ICE Clear Credit but that do not reference the new standard terms supplement are fungible with new contracts cleared and settled by ICE Clear Credit that do reference the new standard terms supplement.¹⁴ One set of amendments would apply to index CDS transactions and a separate but substantially similar set of amendments would apply to single-name CDS transactions.¹⁵

In the case of index CDS, for CDX.NA Index CDS transactions, the definition of CDX.NA Untranching Terms Supplement in Rule 26A-102 in subchapter 26A would be amended to include the new 2020 standard terms supplement for such transactions, as published by ISDA, which incorporates the NTCE Supplement, along with conforming changes to cross-references.¹⁶ Rule 26A-316 would be amended by adding a new paragraph (e), which provides that open positions in CDX.NA Untranching Contracts that are NTCE Amending Contracts would be amended, effective as of the NTCE Effective Date, to reference the updated 2020 standard terms supplement in lieu of the standard terms supplement previously in effect.¹⁷ This will have the effect of converting all

¹³ Id.

¹⁴ Id.

¹⁵ Id.

¹⁶ Id.

¹⁷ Id.

existing CDX.NA Untranching Contracts to reference the new standard terms supplement, such that they will be fungible with new CDX.NA Untranching Contracts, which will also reference the new standard terms supplement.¹⁸ New paragraph (e) would also provide that the amendments will be effective regardless of whether any transaction record in the Deriv/SERV warehouse is updated to reflect the change.¹⁹

Substantially similar changes for other categories of index CDS would also be made in subchapters 26F (for iTraxx Europe Untranching Contracts) and 26J (for iTraxx Asia/Pacific Untranching Contracts).²⁰

In the case of single-name CDS, for Standard North American Corporate (SNAC) Contracts, in subchapter 26B, Rule 26B-616 would be amended by adding a new paragraph (c), which provides that open positions in SNAC Contracts that are NTCE Amending Contracts would be amended, effective as of the NTCE Effective Date, to incorporate the NTCE Supplement and specify that the Fallback Discounting and Credit Deterioration Requirement provisions will be applicable.²¹ The contracts would also be amended to reference the new ISDA physical settlement matrix, to be published as of the NTCE Effective Date (or other relevant implementation date as determined by ICC).²² The amendments will have the effect of converting existing SNAC Contracts to reference the updated physical settlement matrix, such that they will be fungible with new SNAC

¹⁸ Id.

¹⁹ Id.

²⁰ Id.

²¹ Id.

²² Id.

Contracts, which will also reference that matrix.²³ New paragraph (c) would also provide that the amendments will be effective regardless of whether any transaction record in the Deriv/SERV warehouse is updated to reflect the change.²⁴

Substantially similar changes for other categories of single-name CDS would also be made in subchapters 26G (for Standard European Corporate Contracts), 26H (for Standard European Financial Corporate Contracts), 26M (for Standard Australian Corporate Contracts), 26N (for Standard Australia Financial Corporate Contracts), 26O (for Standard Asia Corporate Contracts), 26P (for Standard Asia Financial Corporate Contracts) and 26Q (for Standard Emerging Market Corporate Contracts).²⁵

III. 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 the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to the organization.²⁶ For the reasons given below, the Commission finds that the proposed rule change is consistent with Section 17A(b)(3)(F) of the Act²⁷ and Rule 17Ad-22(d)(1) thereunder.²⁸

²³ Id.

²⁴ Id.

²⁵ Notice, 84 FR at 66037-66038.

²⁶ 15 U.S.C. 78s(b)(2)(C).

²⁷ 15 U.S.C. 78q-1(b)(3)(F).

²⁸ 17 CFR 240.17Ad-22(d)(1).

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 ICC be designed to promote the prompt and accurate clearance and 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 ICC or for which it is responsible, and, in general, to protect investors and the public interest.²⁹

As described above, the NTCE Supplement would amend the underlying legal terms applicable to CDS contracts to which it applies by, among other things, limiting Credit Events to those that reflect a deterioration in the creditworthiness or financial condition of the relevant company. It also would reduce the amount of payout a CDS protection buyer could claim in certain circumstances where the claim for payout is based on an obligation issued by a company at a discount. Further, because ISDA has set an implementation date of January 27, 2020, the NTCE Supplement will apply to all single-name CDS contracts and components of index CDS contracts that incorporate the 2014 ISDA Credit Derivatives Definitions entered into on or after that date.

As noted above, because ICC will clear and settle CDS contracts that are subject to the changes being made by the NTCE Supplement, the proposed rule change would amend the ICC Clearing Rules to incorporate the amendments resulting from the NTCE Supplement, thereby ensuring that ICC's Rules accurately reflect and appropriately apply the legal terms and conditions applicable to such CDS contracts, and that existing

²⁹ 15 U.S.C. 78q-1(b)(3)(F).

contracts that do not reference the new standard terms supplement will be fungible with new contract that do.

In the Commission's view, a lack of clarity in the underlying legal terms and conditions applicable to the transactions that ICC clears and settles could hinder ICC's ability to promptly and accurately clear and settle such transactions. Likewise, disputes regarding the applicable legal terms and conditions of such transactions could lead to disputes or confusion regarding the necessary and appropriate margin submitted in connection with such transactions, thereby threatening ICC's ability to safeguard such margin. Accordingly, by making the changes described above, and in particular by ensuring the ICC's Rules accurately reflect and appropriately apply the legal terms and conditions applicable to the CDS contracts that are cleared and settled by ICC and that existing contracts that do not reference the new standard terms supplement will be fungible with new contract that do, the Commission believes that the proposed rule change would help ensure that ICC's Rules continue to promote the prompt and accurate clearance and settlement of such the CDS contracts and assure the safeguarding of securities and funds in ICC's custody and control. For these same reasons the Commission also finds that the proposed rule change would, in general, protect investors and the public interest.

Therefore, the Commission finds that the proposed rule change is consistent with Section 17A(b)(3)(F) of the Act.³⁰

B. Consistency with Rule 17Ad-22(d)(1)

³⁰ 15 U.S.C. 78q-1(b)(3)(F).

Rule 17Ad-22(d)(1) requires a clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for a well-founded, transparent and enforceable legal framework for each aspect of its activities in all relevant jurisdictions.³¹

As discussed above, the proposed rule change would help to clarify and ensure that ICC's Rules accurately reflect and appropriately apply the legal terms and conditions applicable to the CDS contracts that are cleared and settled by ICC and that existing contracts that do not reference the new standard terms supplement will be fungible with new contract that do. The Commission believes that this, in turn, would help ensure that the ICC Clearing Rules provide a consistent and enforceable legal basis for clearing and settling CDS contracts to which the NTCE Supplement applies in light of the amendments made by the NTCE Supplement.

Therefore, the Commission finds that the proposed rule change is consistent with Rule 17Ad-22(d)(1).

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(b)(3)(F) of the Act³² and Rule 17Ad-22(d)(1)thereunder.³³

³¹ 17 CFR 240.17Ad-22(d)(1).

³² 15 U.S.C. 78q-1(b)(3)(F).

³³ 17 CFR 240. 17Ad-22(d)(1).

IT IS THEREFORE ORDERED pursuant to Section 19(b)(2) of the Act³⁴ that the proposed rule change (SR-ICC-2019-013), be, and hereby is, approved.³⁵

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.³⁶

J. Matthew DeLesDernier
Assistant Secretary

³⁴ 15 U.S.C. 78s(b)(2).

³⁵ 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).

³⁶ 17 CFR 200.30-3(a)(12).