

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-88013; File No. SR-ICEEU-2019-027)

January 22, 2020

Self-Regulatory Organizations; ICE Clear Europe Limited; Order Approving Proposed Rule Change, as Modified by Partial Amendment No. 1, Relating to Amendments to the ICE Clear Europe CDS Procedures

I. Introduction

On December 2, 2019, 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”),¹ and Rule 19b-4 thereunder,² a proposed rule change to amend its CDS Procedures to implement the 2019 Narrowly Tailored Credit Event Supplement to the 2014 ISDA Credit Derivatives Definitions (the “NTCE Supplement”). On December 10, 2019, ICE Clear Europe filed Partial Amendment No. 1 to the proposed rule change.³ The proposed rule change, as modified by Partial Amendment No. 1, was published for comment in the Federal Register on December 18, 2019.⁴ The Commission did not receive comments on the proposed rule change, as modified by Partial Amendment No. 1. For the reasons

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Partial Amendment No. 1 amended the filing to remove from the filed Exhibit 5 certain dates in brackets and replace them with new dates and remove other language left in brackets; update page numbering in the filed Exhibit 2 so that the page numbering in the filed Exhibit 2 states “of 59” instead of “of 60”; and update a reference to paragraph 8(c) of the CDS Procedures in the original filing so that it instead refers to paragraph 8.1(c) of the CDS Procedures.

⁴ Securities Exchange Act Release No. 87722 (Dec. 12, 2019), 84 FR 69421 (Dec. 18, 2019) (SR-ICEEU-2019-027) (“Notice”).

discussed below, the Commission is approving the proposed rule change, as modified by Partial Amendment No. 1 (hereinafter, “proposed rule change”).

II. Description of the Proposed Rule Change

A. Background

Following certain events in the credit default swap (“CDS”)⁵ 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

⁵ The following description is substantially excerpted from the Notice. See Notice, 84 FR at 69421. Capitalized terms not otherwise defined herein have the meanings assigned to them in the ICE Clear Europe Rules or CDS Procedures.

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/>.

events.⁸ First, the NTCE Supplement would change the definition of the “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 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 a Failure to Pay Credit Event satisfies the Credit Deterioration Requirement. As would be the case with other Failure to Pay Credit Events under CDS contracts, the relevant Credit Derivatives Determinations Committee would, in the normal course, make the determination as to whether a Failure to Pay Credit Event satisfies the Credit Deterioration Requirement.

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

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

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>.

corporation at a discount.¹⁰ This would address the potential scenario where a corporation issues a bond at a substantial discount to its 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 CDS Procedures

As described below, the proposed rule change would apply the NTCE Supplement to any non-sovereign single-name and index CDS contract that incorporates the 2014 ISDA definitions (a “2014-type CDS Contract”) and that is open on, or entered into after, January 27, 2020 (or such later date as designated by ICE Clear Europe by Circular).

The proposed rule change would add new defined terms to the CDS Procedures to include new definitions related to the NTCE Supplement. The proposed rule change would further define the effective date of the changes, the “NTCE Protocol Effective Date,” as January 27, 2020, or such later date as designated by ICE Clear Europe by Circular.

The proposed rule change would next incorporate these new definitions into the defined terms associated with non-sovereign single-name and index CDS contracts by amending the CDS Procedures to specify that the applicable contract definitions shall include the NTCE Supplement. This change would apply to any 2014-type CDS Contract that is part of an Open Contract Position on the NTCE Protocol Effective Date or is entered into on or after the NTCE Protocol Effective Date.

In addition to this change, the proposed rule change would make specific changes to the terms associated with single-name CDS and index CDS to update those terms in light of the

¹⁰ Id.

NTCE Supplement. With respect to single-name CDS, the proposed rule change would update certain single-name CDS contracts that are open on the NTCE Protocol Effective Date to reference the new physical settlement matrix that will apply to new single-name CDS entered into after the NTCE Protocol Effective Date. This change would apply to CDS with non-sovereign reference entities that are 2014-type CDS Contracts.

With respect to index CDS, the proposed rule change would amend the terms associated with index CDS contracts to include the new standard terms supplement and confirmations issued in response to the NTCE Supplement. Such new standard terms supplement and confirmations would incorporate the NTCE Supplement. For new index CDS, the proposed rule change would apply the new standard terms supplement and confirmations incorporating the NTCE Supplement to any index CDS submitted for clearing on or after the NTCE Protocol Effective Date. For open index CDS, the proposed rule change would apply the NTCE Supplement to 2014-type CDS Contracts and those that include a 2014-type CDS Contract as a component position on the NTCE Protocol Effective Date. The proposed rule change therefore would convert existing index CDS contracts to reference the new standard terms incorporating the NTCE Supplement, thereby ensuring that those existing contracts would be fungible with new index CDS contracts after the NTCE Protocol Effective Date.

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.¹¹ For the reasons given below, the Commission finds that the proposed rule change is consistent with Section 17A(b)(3)(F) of the Act¹² and Rule 17Ad-22(e)(1) thereunder.¹³

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 ICE Clear Europe 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 ICE Clear Europe or for which it is responsible, and, in general, to protect investors and the public interest.¹⁴

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 determined that the Protocol Effectiveness Condition is

¹¹ 15 U.S.C. 78s(b)(2)(C).

¹² 15 U.S.C. 78q-1(b)(3)(F).

¹³ 17 CFR 240.17Ad-22(e)(1).

¹⁴ 15 U.S.C. 78q-1(b)(3)(F).

satisfied and 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 currently in place or entered into on or after that date.

As noted above, because ICE Clear Europe 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 CDS Procedures to incorporate the amendments resulting from the NTCE Supplement, thereby ensuring that ICE Clear Europe's CDS Procedures accurately reflect and appropriately apply the legal terms and conditions applicable to such CDS contracts.

In the Commission's view, a lack of clarity in the underlying legal terms and conditions applicable to the transactions that ICE Clear Europe clears and settles could hinder ICE Clear Europe'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 ICE Clear Europe's ability to safeguard such margin. Accordingly, by making the changes described above, and in particular by ensuring ICE Clear Europe's CDS Procedures accurately reflect and appropriately apply the legal terms and conditions applicable to the CDS contracts that are cleared and settled by ICE Clear Europe, the Commission believes that the proposed rule change would help ensure that ICE Clear Europe's CDS Procedures continue to promote the prompt and accurate clearance and settlement of such CDS contracts and assure the safeguarding of securities and funds in ICE Clear Europe'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.¹⁵

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

Rule 17Ad-22(e)(1) requires that ICE Clear Europe establish, implement, maintain, and enforce written policies and procedures reasonably designed to provide for a well-founded, clear, transparent, and enforceable legal basis for each aspect of its activities in all relevant jurisdictions.¹⁶ As discussed above, the proposed rule change would help to clarify and ensure that ICE Clear Europe's CDS Procedures accurately reflect and appropriately apply the legal terms and conditions applicable to the CDS contracts that are cleared and settled by ICE Clear Europe. The Commission believes that this, in turn, would help ensure that the ICE Clear Europe CDS Procedures 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(e)(1).¹⁷

¹⁵ 15 U.S.C. 78q-1(b)(3)(F).

¹⁶ 17 CFR 240.17Ad-22(e)(1).

¹⁷ Id.

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 Act¹⁸ and Rule 17Ad-22(e)(1) thereunder.¹⁹

IT IS THEREFORE ORDERED pursuant to Section 19(b)(2) of the Act²⁰ that the proposed rule change, as modified by Partial Amendment No. 1 (SR-ICEEU-2019-027), be, and hereby is, approved.²¹

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²²

Jill M. Peterson
Assistant Secretary

¹⁸ 15 U.S.C. 78q-1(b)(3)(F).

¹⁹ 17 CFR 240.17Ad-22(e)(1).

²⁰ 15 U.S.C. 78s(b)(2).

²¹ 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).

²² 17 CFR 200.30-3(a)(12).