

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-72551; File No. SR-ICEEU-2014-06)

July 8, 2014

Self-Regulatory Organizations; ICE Clear Europe Limited; Order Approving Proposed Rule Change Regarding Investment Losses and Non-Default Losses

I. Introduction

On May 30, 2014, ICE Clear Europe Limited (“ICE Clear Europe”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change SR-ICEEU-2014-06 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> The proposed rule change was published for comment in the Federal Register on June 6, 2014.<sup>3</sup> The Commission received no comment letters regarding the proposed change. For the reasons discussed below, the Commission is granting approval of the proposed rule change.

II. Description

ICE Clear Europe is proposing to update its Rules to address certain investment losses on margin and guaranty fund contributions provided by clearing members (as defined more fully below, “Investment Losses”) as well as other losses to the clearing house arising other than from a clearing member default (as defined more fully below, “Non-Default Losses”), including losses from general business risk and operational risk. According to ICE Clear Europe, the change to its Rules would (i) require ICE Clear Europe to apply a specified amount of its own assets to cover non-default losses and investment losses (“Loss Assets”) and (ii) require clearing members

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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> Securities Exchange Act Release No. 34-72297 (June 2, 2014), 79 FR 32792 (June 6, 2014) (SR-ICEEU-2014-06).

in all product categories to make contributions (referred to as “Collateral Offset Obligations”) to cover Investment Losses (but not other Non-Default Losses) that exceed the available clearing house Loss Assets. ICE Clear Europe has also stated that the proposed change would also limit its liability for losses arising from a failure of a bank or similar custodian.

United Kingdom law requires ICE Clear Europe to have rules addressing the allocation of non-default losses that threaten the clearing house’s solvency and to have plans to maintain continuity of services if such continuity is threatened as a result of such losses. Plans to address losses from general business risk are also an element of the CPSS-IOSCO Principles for Financial Market Infrastructures.<sup>4</sup>

According to ICE Clear Europe, Part 1 of its Rules has been provisionally revised to include new definitions for “Investment Losses” and “Non-Default Losses,” which form the basis of the new loss allocation provisions. ICE Clear Europe has proposed creating a new definition of “Investment Losses” to mean losses incurred or suffered by the clearing house arising in connection with the default of the issuer of any instrument and/or counterparty to any repurchase or reverse repurchase contract or similar transaction in respect of investment or reinvestment by the clearing house of margin (other than variation margin) or guaranty fund contributions other than a loss resulting from the clearing house’s failure to follow its own investment policies or a loss resulting from custodial losses. ICE Clear Europe has stated that Investment Losses will be allocated separately from losses arising from a default. ICE Clear

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<sup>4</sup> ICE Clear Europe has also noted that the Commodity Futures Trading Commission has adopted a similar requirement for systemically important derivatives clearing organizations and “subpart C” derivatives clearing organizations in CFTC Rule 39.33(b)(2), and that the Commission has proposed a similar requirement for certain “covered clearing agencies” in proposed Rule 17Ad-22(e)(15). See Standards for Covered Clearing Agencies, Proposed rule, Securities Exchange Act Release No. 34-71699 (Mar. 12, 2014), 79 FR 29507 (May 22, 2014).

Europe has also stated that an investment loss relating to margin or guaranty fund contributions provided by a defaulting clearing member will be included in the calculation of Investment Losses, and that the amount of Investment Losses will thus not be reduced by any amounts ICE Clear Europe may use from its default resources under Parts 9 and 11 of its Rules (including guaranty fund contributions or assessments) to address losses from a default.

ICE Clear Europe has also proposed to add a definition of “Non-Default Losses” to mean losses suffered by the clearing house (other than Investment Losses) arising in connection with any event other than an event of default and which threaten the solvency of the clearing house. In addition, ICE Clear Europe has proposed a new definition for “Collateral Offset Obligations,” which refers to obligations of a clearing member arising pursuant to new Rule 919, as discussed below, to make payments to the clearing house in respect of Investment Losses, which offset obligations of the clearing house to pay the clearing member or return assets in respect of margin provided to the clearing house by the clearing member. ICE Clear Europe has stated that it has also proposed to add new definitions for “Custodian” (which is used in new Rule 919), and “Loss Assets,” meaning assets of the clearing house itself that are intended to be applied to Investment Losses and Non-Default Losses under Rule 919 as described below.

ICE Clear Europe also proposes changes in Rules 111 and 905 to conform and clarify the description of various types of losses or liabilities that may be borne by the clearing house, through addition of references to “claims” and “shortfalls,” in order to provide for consistent use of language throughout its Rules where other references are made to losses.

ICE Clear Europe has stated that the proposed change would also adopt new Rule 919, which includes the allocation rules for Investment Losses and Non-Default Losses and procedures for applying Collateral Offset Obligations. ICE Clear Europe has also stated that

pursuant to proposed Rule 919(b), Non-Default Losses will be satisfied by applying the available Loss Assets designated by the clearing house and then other available capital or assets of the clearing house, whereas Investment Losses will first be satisfied by applying the available Loss Assets provided by the clearing house, and thereafter by Collateral Offset Obligations as discussed herein. ICE Clear Europe has stated that proposed Rule 919(p) would provide that the amount of Loss Assets provided by ICE Clear Europe will initially be USD 90 million and subject to adjustment by the clearing house by circular from time to time. ICE Clear Europe has also stated that it will not have an obligation to replenish the amount of Loss Assets, if applied to Non-Default Losses or Investment Losses under the proposed change.

According to ICE Clear Europe, pursuant to proposed Rule 919(c), if there is an Investment Loss in an amount greater than the then-available Loss Assets, all clearing members will be required to indemnify the clearing house and pay Collateral Offset Obligations to the clearing house in accordance with Rule 919(d). ICE Clear Europe has stated that it will publish a circular including certain required details of any Investment Loss and the amount of Collateral Offset Obligations due, determined in accordance with the terms of proposed Rule 919(d), based on the proportion of a clearing member's aggregate initial margin and guaranty fund contributions (for all product categories) to the aggregate initial margin and guaranty fund contributions of all clearing members (for all product categories) (in any case other than margin and contributions of defaulting clearing members that are applied or included in the net sum calculation under the Rules as a result of the default). ICE Clear Europe has also stated that pursuant to proposed Rule 919(e), the Collateral Offset Obligation of a clearing member shall not exceed the total of all initial margin and guaranty fund contributions (across all accounts and product categories) that it has deposited with the clearing house at the time of the event giving

rise to the Investment Loss and that to the extent the Investment Losses exceed the amount of available Loss Assets and the capped Collateral Offset Obligations of clearing members, clearing members would not have further obligations to make payments to the clearing house in respect thereof.

ICE Clear Europe has stated that Collateral Offset Obligations are due at the time specified by the clearing house, under proposed Rule 919(f), and will be payable in accordance with the procedures for collection of margin under Rule 302 and its Finance Procedures. Furthermore, ICE Clear Europe has stated that Collateral Offset Obligations may, at the election of the clearing house, be offset against the obligation of the clearing house to return initial margin or guaranty fund contributions, and will be collected pursuant to a call for margin from a proprietary account of the clearing member. ICE Clear Europe has also stated that in the case of a defaulting clearing member, the clearing house may include the Collateral Offset Obligation in any net sum (to reduce any net sum otherwise payable to the defaulting clearing member) or offset it against any other obligation of the clearing house to return any remaining margin or guaranty fund contributions after application in respect of the default. ICE Clear Europe has also stated that collection of the Collateral Offset Obligation from the proprietary account of a clearing member is not intended to preclude a clearing member from passing the cost of the Collateral Offset Obligation to its customer(s), to the extent the obligation relates to customer account margin or otherwise to a customer and to the extent permitted by applicable law.

According to ICE Clear Europe, if the clearing house subsequently recovers amounts in respect of an Investment Loss, proposed Rule 919(h) provides for allocating the recovery to clearing members on a pro rata basis in proportion to their Collateral Offset Obligations satisfied

(after repaying the clearing house for any of its own assets applied in excess of the Loss Assets or any other persons for their assets applied).

ICE Clear Europe has stated that pursuant to proposed Rule 919(i), the obligation of a clearing member to make Collateral Offset Obligations is separate from, and does not reduce, its obligation to provide margin and to make guaranty fund contributions or guaranty fund assessment contributions under the existing rules and pursuant to proposed Rule 919(j), if the clearing house calls for Collateral Offset Obligations in excess of that actually required, it will credit the excess to the relevant clearing members' proprietary accounts, from which it may be withdrawn in accordance with the usual procedure for withdrawal of excess margin under Part 3 of the Rules.

ICE Clear Europe has stated that proposed Rule 919(k) provides that the obligation to provide Collateral Offset Obligations under Rule 919 applies independently from the powers of assessment following clearing member defaults in other parts of the Rules and clarifies that the limits on assessment in Rules 917 and 918 for the F&O and FX product categories do not affect the liability of clearing members for Collateral Offset Obligations. ICE Clear Europe has also stated that proposed Rule 919(l) clarifies that the exercise of rights under Rule 919 does not constitute a Clearing House Event (i.e., a payment default or insolvency of the clearing house). ICE Clear Europe has also stated that proposed Rule 919(m) provides for payments of Collateral Offset Obligations to be made in accordance with the general procedures for payments under Part 3 of the Rules and the Finance Procedures, subject to the clearing house's setoff and netting rights under the Rules.

ICE Clear Europe has stated that under proposed Rule 919(n), the clearing house is not required to pursue any litigation or other action against any person in respect of unpaid amounts

(including those representing an Investment Loss or Non-Default Loss). Furthermore, ICE Clear Europe has stated that, as discussed above, to the extent the clearing house recovers amounts in respect of an Investment Loss, proposed Rule 919(h) provides for allocating such recovery to clearing members that have paid Collateral Offset Obligations. ICE Clear Europe has also stated that proposed Rule 919(o) allows the clearing house to make currency conversions in making determinations under Rule 919.

ICE Clear Europe has stated that pursuant to proposed Rule 919(q), it must notify clearing members of the amount of Loss Assets used from time to time. ICE Clear Europe is not required to replenish the amount of Loss Assets if used, although it may elect to do so. ICE Clear Europe has also stated that proposed Rule 919(q) provides that the clearing house may replenish any regulatory capital as required to bring it in compliance with applicable laws at any time, including following an Investment Loss or other Non-Default Loss, and no such recapitalization will result in a reduction of any obligation of any clearing member to pay Collateral Offset Obligations, or the size of any Investment Loss. ICE Clear Europe has also stated that the replenishment of required regulatory capital does not in itself require, or result in, a replenishment of Loss Assets.

ICE Clear Europe has stated that under proposed Rule 919(r), the clearing house is not liable to any clearing member, customer or any other person for losses arising from a failure of a payment or security services provider, including a Custodian such as a payment or custody bank, securities depository or securities settlement system.

ICE Clear Europe has stated that it has proposed other related changes to Parts 11, 12 and 16 of its Rules. First, ICE Clear Europe has proposed a change to Rule 1103(e) to allow the Loss Assets to be held together with other clearing house contributions to the guaranty fund (without

affecting the limitations in the existing rules and Rule 919 on the use of such assets) and that as a result of this change, each clearing house contribution is no longer required to be held in a separate account, although the three clearing house guaranty fund contributions and the Loss Assets are required to be held separately from other clearing house assets. Second, ICE Clear Europe has proposed conforming changes to definitions relating to custodians in Rule 1201.

ICE Clear Europe has proposed new Rule 1606(b) to address certain matters relating to the investment of customer collateral in the form of cash provided by FCM/BD Clearing Members under applicable CFTC regulations. ICE Clear Europe has stated that the revised rule confirms that such cash can only be invested in U.S. treasury securities in accordance with applicable law and further provides that FCM/BD Clearing Members must direct the clearing house whether to so invest such cash or to leave it uninvested (and deems the clearing member to have instructed the clearing house to invest such collateral if it does not provide direction).

### III. Discussion and Commission Findings

Section 19(b)(2)(C) of the Act<sup>5</sup> directs the Commission to approve a proposed rule change of a self-regulatory organization if the Commission finds that such proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to such self-regulatory organization. Section 17A(b)(3)(F) of the Act<sup>6</sup> requires, among other things, that the rules of a clearing agency are 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

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<sup>5</sup> 15 U.S.C. 78s(b)(2)(C).

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



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.

The Commission finds that the proposed rule change is consistent with Section 17A of the Act<sup>7</sup> and the rules thereunder applicable to ICE Clear Europe. Because the proposed rule change specifies the procedures for allocation and payment of Investment Losses and Non-Default Losses, and provide for pre-funded Loss Assets to address Investment Losses and Non-Default Losses and the ability to call Collateral Offset Obligations from clearing members to address Investment Losses exceeding the Loss Assets, the Commission finds that the proposed rule change will enhance ICE Clear Europe's ability to promptly bear such losses, replenish its financial resources and continue clearing operations following an Investment Loss or Non-Default Loss, thus promoting the prompt and accurate clearance and settlement of securities transactions and, to the extent applicable, derivative agreements, contracts and transactions and contribute to the safeguarding of securities and funds which are in the custody or control of ICE Clear Europe or for which it is responsible in a manner consistent with the Act and the regulations thereunder applicable to ICE Clear Europe, in particular, Section 17(A)(b)(3)(F).<sup>8</sup>

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<sup>7</sup> 15 U.S.C. 78q-1.

<sup>8</sup> 15 U.S.C. 78q-1(b)(3)(F).

IV. Conclusion

On the basis of the foregoing, the Commission finds that the proposal is consistent with the requirements of the Act and in particular with the requirements of Section 17A of the Act<sup>9</sup> and the rules and regulations thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>10</sup> that the proposed rule change (File No. SR-ICEEU-2014-06) be, and hereby is, approved.<sup>11</sup>

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>12</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>9</sup> 15 U.S.C. 78q-1.

<sup>10</sup> 15 U.S.C. 78s(b)(2).

<sup>11</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>12</sup> 17 CFR 200.30-3(a)(12).