

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-74085; File No. SR-ICEEU-2014-20)

January 16, 2015

Self-Regulatory Organizations; ICE Clear Europe Limited; Order Granting Approval of Proposed Rule Change Relating to CDS Pricing Policy

I. Introduction

On November 24, 2014, ICE Clear Europe Limited (“ICE Clear Europe”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change SR-ICEEU-2014-20 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder.² The proposed rule change was published for comment in the Federal Register on December 9, 2014.³ 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 of the Proposed Rule Change

ICE Clear Europe is proposing this change to revise the ICE Clear Europe CDS End-of-Day Price Discovery Policy (“CDS Pricing Policy”) to incorporate enhancements to its price discovery process. The revisions do not require any changes to ICE Clear Europe’s Clearing Rules or Procedures.

According to ICE Clear Europe, it currently uses a “cross and lock” algorithm as part of its price discovery process for CDS Contracts. As described by ICE Clear Europe, under this algorithm, bids and offers derived from Clearing Member submissions are matched by sorting

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Securities Exchange Act Release No. 34-73731 (Dec. 3, 2014), 79 FR 73126 (Dec. 9, 2014) (SR-ICEEU-2014-20).

them from highest to lowest and lowest to highest levels, respectively. This sorting process pairs the Clearing Member submitting the highest bid price with the Clearing Member submitting the lowest offer price, the Clearing Member submitting the second highest bid price with the Clearing Member submitting the second-lowest offer price, and so on. The algorithm then identifies crossed and/or locked pairs (or “markets”). Crossed markets are the Clearing Member pairs generated by the sorting process for which the bid price of one Clearing Member is above the offer price of the matched Clearing Member. Locked markets are the Clearing Member pairs where the bid and the offer are equal. The mid-point of the bid and offer of the first non-crossed, non-locked matched market is the final end-of-day level (with additional steps taken to remove off-market submissions from influencing the final level). As stated by ICE Clear Europe, this process captures the market dynamics of trading; however, final pricing levels are ultimately determined by a single bid and a single offer, which results in the ability for one submission to influence the outcome.

ICE Clear Europe proposes enhancements to this methodology to improve the consistency of prices and reduce the sensitivity of the final end-of-day level to a single Clearing Member’s submission. ICE Clear Europe proposes that, under the new “cross and lock” methodology, the average of the mid-points of all non-crossed, non-locked matched markets for which the difference between the matched market bid and matched market offer is less than or equal to one bid-offer width is used as the final level (with additional steps taken to remove off-market submissions from influencing the final level). According to ICE Clear Europe, this approach would make end-of-day price determinations less sensitive to outlying submissions.

In addition, ICE Clear Europe proposes a clarification to the calculation of a Clearing Member’s open interest for purposes of the end-of-day price submission process to take into

account the aggregate of both house and client positions carried by the Clearing Member. ICE Clear Europe also proposes revisions to the CDS Pricing Policy to correct the minimum number of Clearing Members that need to have open interest in a particular instrument; this change, as stated by ICE Clear Europe, conforms to current practice by the Clearing House.

ICE Clear Europe further proposes revisions to clarify that notional limits for firm trades that may be assigned to Clearing Members as a result of the end-of-day price submission process will be established at risk sub-factor and sector levels, and to clarify the sequencing of firm trades for determining breaches of those limits, including accounting for the applicable risk sub-factor and addressing sequencing within a particular instrument that is part of a particular risk sub-factor, if necessary.

Additionally, ICE Clear Europe proposes amendments to certain requirements applicable to the unwinding of firm trades entered into by Clearing Members. ICE Clear Europe states that its current policy does not require firm trades to be maintained for any particular period of time, but it requires Clearing Members that elect to unwind a firm trade to do so at the then-current market price. ICE Clear Europe contends that there are practical difficulties with objectively determining whether an unwind transaction was executed at the then-current market price and therefore this requirement can be difficult to enforce. ICE Clear Europe proposes revising the policy to replace the requirement that unwinds be executed at the then-current market price with the requirement that any unwind be executed in a competitive manner. Further, ICE Clear Europe proposes adding the requirement that, upon request, Clearing Members be able to demonstrate to the Clearing House's reasonable satisfaction that such unwind transaction was executed in a competitive manner. ICE Clear Europe proposes adding a non-exclusive list of examples of how Clearing Members may be able to demonstrate competitive execution of

unwind transactions. Such examples would include: (i) execution on an available trading venue; (ii) multiple dealer quotes received and execution of the unwind transaction at the best quoted price; or (iii) placement of the unwind transaction with an interdealer broker with price terms and instructions commensurate with a competitive execution.

In addition, ICE Clear Europe proposes amendments to make certain clarifications with respect to permissible reversing transactions with respect to firm trades and the manner in which the Clearing House designates that actively traded benchmark instruments are not eligible for reversing transactions.

Furthermore, ICE Clear Europe proposes certain other conforming changes to the CDS Pricing Policy as a consequence of a prior rule change.⁴ Specifically, ICE Clear Europe proposes adding references to risk sub-factors (as that term is described in the CDS Risk Policy) throughout the CDS Pricing Policy, as well as conforming changes to various references to risk factors. Finally, ICE Clear Europe proposes various non-substantive drafting clarifications throughout the CDS Pricing Policy.

III. Discussion and Commission Findings

Section 19(b)(2)(C) of the Act⁵ 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 Act⁶ requires, among other things, that the rules of a clearing agency are designed to promote the prompt and accurate

⁴ See Exchange Act Release No. 34-73156 (Sept. 19, 2014), 79 FR 57629 (Sept. 25, 2014) (SR-ICEEU-2014-13).

⁵ 15 U.S.C. 78s(b)(2)(C).

⁶ 15 U.S.C. 78q-1(b)(3)(F).

clearance and settlement of securities transactions and, to the extent applicable, derivative agreements, contracts, and transactions.

The Commission finds that the proposed rule change is consistent with Section 17A of the Act⁷ and the rules thereunder applicable to ICE Clear Europe. The proposed revisions to the “cross and lock” methodology are expected to reduce the sensitivity of the final price level to a single Clearing Member’s submission, resulting in more consistent day-over-day end-of-day levels. Furthermore, the proposed revisions that would require Clearing Members to execute unwinds in a competitive manner and, upon request, demonstrate to ICE Clear Europe’s reasonable satisfaction that the Clearing Member complied with this requirement, are expected to make the CDS Pricing Policy more readily enforceable, while maintaining the incentive for Clearing Members to provide accurate price submissions.

ICE Clear Europe’s clarifications concerning (1) the referencing of risk sub-factors, including the clarifications concerning the notional limits applicable to firm trades, (2) permissible reversing transactions and (3) calculations of a Clearing Member’s open interest each clarify or conform the text of the CDS Pricing Policy in accordance with ICE Clear Europe’s existing practice. All other revisions proposed by ICE Clear Europe as a result of this proposed rule change are conforming changes to other rule changes previously filed by ICE Clear Europe. The proposed rule change is therefore reasonably expected to provide a pricing methodology that more accurately reflects the market level and existing practice. The proposed rule change is also reasonably expected to be more readily enforceable and to enhance incentives for Clearing Members to provide accurate pricing information. As such, the Commission believes that the changes are designed to promote the prompt and accurate settlement of

⁷ 15 U.S.C. 78q-1.

securities and derivatives transactions, and, therefore, are consistent with the requirements of the Act and the rules and regulations thereunder applicable to ICE Clear Europe, in particular, Section 17(A)(b)(3)(F).⁸

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 Act⁹ and the rules and regulations thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹⁰ that the proposed rule change (File No. SR-ICEEU-2014-20) be, and hereby is, approved.¹¹

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

Brent J. Fields
Secretary

⁸ 15 U.S.C. 78q-1(b)(3)(F).

⁹ 15 U.S.C. 78q-1.

¹⁰ 15 U.S.C. 78s(b)(2).

¹¹ 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).

¹² 17 CFR 200.30-3(a)(12).