

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-70464; File No. SR-ICEEU-2013-11)

September 20, 2013

Self-Regulatory Organizations; ICE Clear Europe Limited; Order Approving Proposed Rule Change Related to Enhanced Margin and Guaranty Fund Methodology

I. Introduction

On August 14, 2013, ICE Clear Europe Limited (“ICE Clear Europe”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change SR-ICEEU-2013-11 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 August 20, 2013.<sup>3</sup> The Commission did not receive any comments on the proposed rule change. This order approves the proposed rule change.

II. Description of the Proposed Rule Change

ICE Clear Europe proposes to adopt changes to its enhanced margin and guaranty fund methodology (“Decomp Model”) for cleared credit default swaps (“CDS”) that address the additional risk arising from the fact that certain cleared index CDS contracts include as reference entities Clearing Members or affiliates of Clearing Members (“self-referencing CDS”) (such additional risk is hereinafter referred to as “Specific Wrong-Way Risk”). ICE Clear Europe also proposes to adopt changes to the liquidation period used in determining the initial margin requirement for customer CDS positions. ICE Clear Europe has developed its Decomp Model,

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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. 34-70201 (Aug. 14, 2013), 78 FR 51248 (Aug. 20, 2013) (SR-ICEEU-2013-11).

as previously approved by the Commission,<sup>4</sup> to permit appropriate portfolio margining between related index and single-name CDS positions by recognizing that index CDS instruments are, for risk management purposes, essentially a composition of specific single-name CDS.

In anticipation of the launch of customer clearing in CDS, and in furtherance of the ongoing European regulatory reform program designed to improve the safety and soundness of the European derivatives markets, ICE Clear Europe proposes to adopt certain enhancements to the Decomp Model to address Specific Wrong-Way Risk. Although ICE Clear Europe does not permit a Clearing Member to enter into or maintain a single-name CDS referencing itself or an affiliate, a self-referencing CDS position may arise through an index CDS where the Clearing Member or an affiliate is a component of the index.

Under the enhancements to the Decomp Model, ICE Clear Europe will require an additional contribution to the CDS Guaranty Fund from those Clearing Members that present Specific Wrong-Way Risk, up to a defined threshold. The additional guaranty fund contribution amount is calculated based on the highest uncollateralized loss-given-default exposure arising from any of the self-referencing CDS positions of Clearing Members. In addition, each such Clearing Member will be required to provide additional initial margin to collateralize any Specific Wrong-Way Risk presented by its positions in excess of the defined threshold.

The proposed amendments also would enhance the CDS Guaranty Fund calculation methodology to cover the uncollateralized losses that would result from up to five single names - including two Clearing Members and three other single names - that would cause the greatest losses upon default. Consequently, the proposed amendments to the guaranty fund calculation

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<sup>4</sup> See Order Approving Proposed Rule Change, as Modified by Amendment No. 1 Thereto, Relating to Enhanced Margin Methodology, Securities Exchange Act Release No. 34-68955 (Feb. 20, 2013), 78 FR 13130 (Feb. 26, 2013) (SR-ICEEU-2012-11).

account for the potential increased amount of uncollateralized loss in cases where the Clearing Members are reference entities in cleared index CDS contracts.

Additionally, ICE Clear Europe proposes to change the liquidation period for calculation of initial margin for customer CDS positions. Currently, the Decomp Model provides portfolio risk coverage against at least 5-day market realizations. ICE Clear Europe intends to facilitate porting of client positions and contemplates that porting would take up to 2 days following the default of a Clearing Member. After taking into account the porting period, the risk horizon for liquidation of customer CDS portfolios would be extended to 7 days. The increased liquidation period used in determining the initial margin requirement for customer CDS positions will only apply to the spread response, basis and interest rate risk components of the model.

The ICE Clear Europe CDS Risk Policy, the CDS Risk Model Description methodology document, CDS Back-Testing Framework and CDS Default Management Framework have been updated to account for the enhancements described above.

ICE Clear Europe believes that the amendments are consistent with the requirements of Section 17A of the Act<sup>5</sup> and the regulations thereunder applicable to it, including the standards under Rule 17Ad-22.<sup>6</sup> In particular, ICE Clear Europe believes the amendments will enhance the clearinghouse's margin methodology by more accurately addressing Specific Wrong-Way Risk presented by index CDS positions of Clearing Members. ICE Clear Europe further believes that the amendments will enhance the guaranty fund calculation methodology, and adjust the liquidation period for customer positions used in calculating initial margin for CDS. In ICE Clear Europe's view, the amendments will therefore promote the prompt and accurate clearance and settlement of securities transactions, the safeguarding of securities and funds in the custody

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<sup>5</sup> 15 U.S.C. 78q-1.

<sup>6</sup> 17 CFR 240.17Ad-22.

or control of ICE Clear Europe and the protection of investors and the public interest, within the meaning of Section 17A(b)(3)(F) of the Act.<sup>7</sup> Furthermore, ICE Clear Europe believes the revisions will enhance ICE Clear Europe's financial resources, consistent with the requirements of Rule 17Ad-22(b),<sup>8</sup> by requiring additional initial margin and CDS Guaranty Fund contributions to address Specific Wrong-Way Risk.

### III. Discussion and Commission Findings

Section 19(b)(2)(C) of the Act<sup>9</sup> 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. Section 17A(b)(3)(F) of the Act<sup>10</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 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.

After careful review, the Commission finds that the proposed rule change is consistent with Section 17A the Act<sup>11</sup> and the rules thereunder applicable to ICE Clear Europe. The Commission believes the proposed enhancements to ICE Clear Europe's margin and guaranty fund methodologies are designed to promote the prompt and accurate clearance and settlement of

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<sup>7</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>8</sup> 17 CFR 240.17Ad-22(b).

<sup>9</sup> 15 U.S.C. 78s(b)(2)(C).

<sup>10</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>11</sup> 15 U.S.C. 78q-1.

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, in furtherance of Section 17A(b)(3)(F) of the Act.<sup>12</sup> In particular, the proposed rules more accurately address Specific Wrong-Way risk presented by the index CDS positions of ICE Clear Europe's Clearing Members by requiring additional CDS Guaranty Fund contributions from those Clearing Members that present Specific Wrong-Way Risk, up to a defined threshold, and additional initial margin charges to collateralize any Specific Wrong-Way Risk presented in excess of this defined threshold. The proposed amendments also enhance the CDS Guaranty Fund calculation methodology to cover the uncollateralized losses that would result from up to five single names – including two Clearing Members and three other single names - that would cause the greatest losses upon default. Additionally, the proposed rule change would increase the liquidation period from 5 to 7 days for calculation of the spread response, basis, and interest rate risk components of initial margin for customer CDS positions to account for situations where porting of customer positions should fail during the 2-day period following the default of a Clearing Member.

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<sup>12</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>13</sup> and the rules and regulations thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>14</sup> that the proposed rule change (SR-ICEEU-2013-11) be, and hereby is, approved.<sup>15</sup>

For the Commission by the Division of Trading and Markets, pursuant to delegated authority.<sup>16</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>13</sup> 15 U.S.C. 78q-1.

<sup>14</sup> 15 U.S.C. 78s(b)(2).

<sup>15</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>16</sup> 17 CFR 200.30-3(a)(12).