

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-84033; File No. SR-ICEEU-2018-009)

September 5, 2018

Self-Regulatory Organizations; ICE Clear Europe Limited; Order Approving Proposed Rule Change Relating to Amendments to the ICE Clear Europe CDS End-of-Day Price Discovery Policy (“Price Discovery Policy”)

I. Introduction

On July 11, 2018, 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”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change (SR-ICEEU-2018-009) to revise ICE Clear Europe’s CDS End-of-Day Price Discovery Policy (“Price Discovery Policy”) related to the bid-offer width (“BOW”) methodology for pricing single-name credit default swap (“CDS”) instruments.<sup>3</sup> The proposed rule change was published for comment in the Federal Register on July 24, 2018.<sup>4</sup> The Commission did not receive comments on the proposed rule change. For the reasons discussed below, the Commission is approving the proposed rule change.

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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> The Price Discovery Policy uses the term “instrument” to refer to the complete set of contractual terms that affect the value of a CDS contract. For single-name CDS contracts, these terms include the reference entity, currency, debt tier, document clause, coupon, and scheduled termination date.

<sup>4</sup> Securities Exchange Act Release No. 34-83665 (July 18, 2018), 83 FR 35048 (July 24, 2018) (SR-ICEEU-2018-009) (“Notice”).

## II. Description of the Proposed Rule Change

Currently, ICE Clear Europe uses end-of-day (“EOD”) price levels for risk management purposes.<sup>5</sup> Each business day, ICE Clear Europe determines EOD prices in accordance with its Price Discovery Policy.<sup>6</sup> Specifically, ICE Clear Europe uses BOWs to determine these EOD price levels.<sup>7</sup> The BOW is intended to estimate the bid-offer width for the market available for each clearing-eligible instrument at a specified time on each business day.<sup>8</sup> The BOWs are then used in ICE Clear Europe’s price discovery process as inputs in the determination of EOD levels and other risk management matters.<sup>9</sup>

ICE Clear Europe derives BOWs for single-name CDS instruments based on observed intraday spread-quotes for the most actively traded instrument (“MATI”) across the term structure and cleared coupons (otherwise known as “consensus BOW”).<sup>10</sup> ICE Clear Europe calculates the consensus BOW for each relevant CDS instrument based on specified averages of the quotes provided by CDS Clearing Members. ICE Clear Europe adjusts consensus BOWs by a “scrape factor” to reflect differences between the BOWs provided by clearing members in intraday quotes and BOWs achieved in the market.<sup>11</sup>

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<sup>5</sup> Capitalized terms used herein but not otherwise defined have the meaning set forth in the ICE Clear Europe Clearing Rules, which is available at [https://www.theice.com/publicdocs/clear\\_europe/rulebooks/rules/Clearing\\_Rules.pdf](https://www.theice.com/publicdocs/clear_europe/rulebooks/rules/Clearing_Rules.pdf), or in the Price Discovery Policy.

<sup>6</sup> Notice, 83 FR at 35049.

<sup>7</sup> Id.

<sup>8</sup> Id.

<sup>9</sup> Id.

<sup>10</sup> Id.

<sup>11</sup> Id.

ICE Clear Europe also applies various other adjustments to the consensus BOWs to reflect differences in instrument liquidity at longer and shorter maturities, and at higher and lower coupons.<sup>12</sup> Moreover, ICE Clear Europe currently uses the ISDA CDS Standard Model to convert price submissions for single-name CDS instruments from the form of a yearly premium of a CDS in basis points, per amount insured (“spread”) to price submissions in the form of an upfront payment as a percentage of a fixed premium (“price terms”).

The proposed rule change would enhance the methodology ICE Clear Europe uses to determine BOWs for single-name instruments by amending the Price Discovery Policy to (1) compute a consensus BOW for each benchmark single-name instrument; (2) determine the final EOD BOW as the greater of an instrument’s final systematic BOW and a dynamic BOW; (3) eliminate the use of the ISDA CDS Standard Model from the computation of BOWs for single-name instruments; and (4) update associated governance provisions.

First, the proposed rule change would compute a consensus BOW for each benchmark single-name CDS instrument. Specifically, Ice Clear Europe would compute a consensus BOW for each benchmark instrument, as compared to how Ice Clear Europe currently only computes a consensus BOW for the most actively traded instrument.<sup>13</sup> Likewise, rather than deriving consensus BOWs only from intraday quotes, ICE Clear Europe would compute consensus BOWs as a price-based floor plus a fraction of the single-name CDS instrument’s currently observed level (based on the average of price-

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<sup>12</sup> Notice, 83 FR at 35049.

<sup>13</sup> Id.

space levels submitted by CDS Clearing Members as part of the EOD price discovery process).<sup>14</sup> ICE Clear Europe would continue to apply various factors to the most actively traded instrument's consensus BOW to reflect differences in liquidity at longer and shorter maturities and at higher and lower coupons.<sup>15</sup> The proposed rule change would also extend the application of price-based BOW floors from the 0/3-month, 6-month and 1-year benchmark tenors to the entire set of benchmark tenors.<sup>16</sup>

ICE Clear Europe would then apply scaling factors to the consensus BOWs.<sup>17</sup> The amended Price Discovery Policy would refer to the BOWs, after application of scaling factors, as "systematic BOWs".<sup>18</sup> The scaling factors would reflect differences in instrument liquidity at longer and shorter maturities, and at higher and lower coupons.<sup>19</sup> To determine systematic BOWs for each benchmark instrument at the most actively traded coupon ("MATC"), ICE Clear Europe would apply scaling factors based upon the remaining time left in the CDS ("tenor scaling") to the corresponding consensus BOWs.<sup>20</sup> The tenor scaling factors would reflect the BOW of each tenor relative to the BOW of the most actively traded tenor.<sup>21</sup> ICE Clear Europe would determine systematic BOWs for each benchmark instrument at other coupons by applying a combination of tenor scaling

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<sup>14</sup> Notice, 83 FR at 35049.

<sup>15</sup> Id.

<sup>16</sup> Id.

<sup>17</sup> Id.

<sup>18</sup> Id.

<sup>19</sup> Id.

<sup>20</sup> Id.

<sup>21</sup> Id.

factors and coupon scaling factors to the corresponding consensus BOWs.<sup>22</sup> Coupon scaling factors would adjust the BOW to reflect decreased market activity at coupons larger or smaller than the MATC, and accordingly would produce a wider BOW for such coupons as compared to the MATC.<sup>23</sup>

ICE Clear Europe would also apply a variability factor, which would be an additional scaling factor to widen the BOW to account for volatile or fast-moving market conditions.<sup>24</sup> The variability factor would be designed to reflect observed variability levels in intraday quotes.<sup>25</sup> ICE Clear Europe would determine the amount of the variability factor on the basis of a market proxy variability band (numbering 0-3).<sup>26</sup> ICE Clear Europe would assign a single-name instrument to a market proxy variability band based on the instrument's market-proxy group, as determined by ICE Clear Europe. ICE Clear Europe may apply a similar variability factor under the current approach on a discretionary basis.<sup>27</sup> After applying this variability factor, ICE Clear Europe would arrive at the final systematic EOD BOW based on the applicable variability band.<sup>28</sup>

Second, ICE Clear Europe would determine the final EOD BOW as the greater of a single-name CDS instrument's final systematic EOD BOW, and a BOW established for

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<sup>22</sup> Notice, 83 FR at 35049.

<sup>23</sup> Id.

<sup>24</sup> Id.

<sup>25</sup> Id.

<sup>26</sup> Id.

<sup>27</sup> Id.

<sup>28</sup> Id.

the instrument based on the dispersion of price-based EOD submissions by CDS Clearing Members for the given instrument (such BOW the “dynamic BOW”).<sup>29</sup>

Third, the proposed rule change would eliminate the use of the ISDA CDS Standard Model from the computation of BOWs for single-name CDS instruments. As ICE Clear Europe would now accept price submissions for single-name CDS instruments only in price terms, ICE Clear Europe would no longer need the ISDA CDS Standard Model to compute single-name BOWs.<sup>30</sup> ICE Clear Europe would continue to use the ISDA CDS Standard Model for certain other purposes in which it may need to convert between spread and price terms, however, and therefore the proposed rule change would retain references to the model in the revised Price Discovery Policy.<sup>31</sup> Similarly, because ICE Clear Europe would now accept price submissions for single-name CDS instruments only in price terms, the proposed rule change would remove the requirement for ICE Clear Europe to provide single-name BOWs in spread terms.<sup>32</sup>

Finally, the proposed rule change would revise the governance provisions of the Price Discovery Policy. Under the revisions, and consistent with the amendments to the methodology described above, ICE Clear Europe’s clearing risk department, in consultation with the trading advisory committee, would establish the parameters used in the EOD price discovery process.<sup>33</sup> ICE Clear Europe’s clearing risk department would

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<sup>29</sup> Notice, 83 FR at 35049.

<sup>30</sup> Id.

<sup>31</sup> Notice, 83 FR at 35049 n.4.

<sup>32</sup> Notice, 83 FR at 35049.

<sup>33</sup> Id.

also be responsible for determining the price-based floors and scaling factors used to establish BOWs.<sup>34</sup>

### III. Discussion and 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 such proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to such organization.<sup>35</sup> For the reasons given below, the Commission finds that the proposed rule change is consistent with Section 17A(b)(3)(F) of the Act,<sup>36</sup> and Rules 17Ad-22(e)(2)(i), (e)(6)(ii), and (e)(6)(iv) thereunder.<sup>37</sup>

#### 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, as well as 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.<sup>38</sup>

As discussed above, the proposed rule change would enhance ICE Clear Europe's EOD price discovery process for single-name CDS instruments by amending the Price

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<sup>34</sup> Notice, 83 FR at 35049.

<sup>35</sup> 15 U.S.C. 78s(b)(2)(C).

<sup>36</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>37</sup> 17 CFR 240.17Ad-22(e)(2)(i), (e)(6)(ii), and (e)(6)(iv).

<sup>38</sup> 15 U.S.C. 78q-1(b)(3)(F).

Discovery Policy to (1) compute a consensus BOW for each benchmark single-name instrument; (2) determine the final EOD BOW as the greater of an instrument's final systematic BOW and a dynamic BOW; (3) eliminate the use of the ISDA CDS Standard Model from the computation of BOWs for single-name instruments; and (4) update associated governance provisions.

Taken as a whole, the Commission believes the proposed rule change would enhance ICE Clear Europe's ability to determine the EOD BOW for single-name CDS instruments. The Commission believes the proposed rule change would permit ICE Clear Europe to determine BOWs more consistently across single-name instruments on all reference entities, including those for which only sparse intraday data is available, by computing a consensus BOW for each benchmark single-name instrument. In addition, by extending the application of price-based BOW floors to the entire set of benchmark tenors instead of solely the 0/3 month, 6 month, and 1-year benchmark tenors, the Commission believes that ICE Clear Europe would be able to more consistently compute the EOD BOW for a wider range of single-name CDS instruments. Moreover, the Commission believes that the adoption of a new dynamic BOW would help the BOW to better reflect current market conditions given that the dynamic BOW would widen BOWs in response to the observed dispersion of price-space levels submitted in the EOD price discovery process. Finally, the Commission believes that updating the associated governance provisions would help ensure that the EOD price discovery process remains effective by making clear the responsibilities for establishing the parameters, price-based floors, and scaling factors used in the EOD price discovery process.

Consequently, the Commission believes that the proposed rule change would help improve ICE Clear Europe's EOD pricing process as a whole by considering additional relevant information and a wider range of instruments. Based on these improvements, the Commission believes that the proposed rule change would also help improve the operation and effectiveness of ICE Clear Europe's margin system because ICE Clear Europe uses EOD prices to calculate and collect such margin. Given that an effective margin system is necessary to manage ICE Clear Europe's credit exposures to its Clearing Members and the risks associated with clearing security based swap-related portfolios, the Commission believes that the proposed rule change would help improve ICE Clear Europe's ability to avoid losses that could result from the mismanagement of such credit exposures and risks. Because such losses could disrupt ICE Clear Europe's ability to promptly and accurately clear security based swap transactions, the Commission believes that the proposed rule change, by improving the EOD price input to ICE Clear Europe's margin system and thereby improving the operation and effectiveness of such margin system, would help promote the prompt and accurate clearance and settlement of securities transactions.

Similarly, given that mismanagement of ICE Clear Europe's credit exposures to its Clearing Members and the risks associated with clearing security based swap-related portfolios could cause ICE Clear Europe to realize losses on such portfolios and threaten ICE Clear Europe's ability to operate, thereby threatening access to securities and funds in ICE Clear Europe's control, the Commission believes that the proposed rule change would help assure the safeguarding of securities and funds which are in the custody or control of ICE Clear Europe or for which it is responsible. Finally, for both of these

reasons, the Commission believes the proposed rule change is consistent with protecting investors and the public interest.

Therefore, the Commission finds that the proposed rule change would promote the prompt and accurate clearance and settlement of securities transactions, assure the safeguarding of securities and funds in ICE Clear Europe's custody and control, and, in general, protect investors and the public interest, consistent with the Section 17A(b)(3)(F) of the Act.<sup>39</sup>

B. Consistency with Rule 17Ad-22(e)(2)(i)

Rule 17Ad-22(e)(2)(i) requires that ICE Clear Europe establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for governance arrangements that are clear and transparent.<sup>40</sup>

As discussed above, the proposed rule change would revise ICE Clear Europe's Price Discovery Policy to update the responsibilities of ICE Clear Europe's clearing risk department. Under the revised Price Discovery Policy, the clearing risk department, in consultation with the trading advisory committee, would establish the parameters used in the EOD price discovery process, including determining the price-based floors and scaling factors used to establish BOWs. The Commission believes that the proposed rule change would thus help ICE Clear Europe assign responsibility within ICE Clear Europe's existing governance structure for important aspects of EOD price discovery, such as setting parameters and scaling factors. The Commission further believes that the proposed rule change would help improve the effectiveness of the EOD price discovery

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<sup>39</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>40</sup> 17 CFR 240.17Ad-22(e)(2)(i).

process by specifically requiring the clearing risk department to consult the trading advisory committee, which would provide insight into current market dynamics and conditions.

Therefore, for the above reasons the Commission finds that the proposed rule change is consistent with Rule 17Ad-22(e)(2)(i).<sup>41</sup>

C. Consistency with Rule 17Ad-22(e)(6)(ii)

Rule 17Ad-22(e)(6)(ii) requires that ICE Clear Europe establish, implement, maintain and enforce written policies and procedures reasonably designed to cover its credit exposures to its participants by establishing a risk-based margin system that marks participant positions to market and collects margin, including variation margin or equivalent charges if relevant, at least daily and includes the authority and operational capacity to make intraday margin calls in defined circumstances.<sup>42</sup>

As discussed above, the proposed rule change would enhance ICE Clear Europe's EOD price discovery by amending the Price Discovery Policy to (1) compute a consensus BOW for each benchmark single-name instrument; (2) determine the final EOD BOW as the greater of an instrument's final systematic BOW and a dynamic BOW; and (3) eliminate the use of the ISDA CDS Standard Model from the computation of BOWs for single-name instruments.

The Commission believes that these changes, taken together, would help enhance ICE Clear Europe's ability to determine the EOD BOW for single-name CDS instruments. By eliminating the use of the ISDA CDS Standard Model from the

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<sup>41</sup> 17 CFR 240.17Ad-22(e)(2)(i).

<sup>42</sup> 17 CFR 240.17Ad-22(e)(6)(ii).

computation of single-name BOWs, accepting submissions only in price terms, and computing a consensus BOW for each benchmark single-name CDS instrument, the Commission believes the proposed rule change would help ICE Clear Europe to determine BOWs more consistently across single-name instruments on all reference entities, including those for which little intraday data is available. In addition, as noted above, the dynamic BOW would widen BOWs in response to the observed dispersion of price-space levels submitted in the EOD price discovery process. Thus, by determining the final EOD BOW as the greater of an instrument's final systematic BOW and a dynamic BOW, the Commission believes the proposed rule change would help the BOW to better reflect current market conditions.

Consequently, the Commission believes that the proposed rule change would help improve ICE Clear Europe's EOD pricing process by taking into account additional relevant information and considering a wider range of instruments in the pricing process. Because ICE Clear Europe uses EOD prices to mark participant positions to market and establish and collect margin, including variation margin, the Commission believes that improvements to the EOD pricing process would also enhance ICE Clear Europe's covering of credit exposures to its participants and collection of margin. Moreover, the Commission believes the governance enhancements described above would help ensure that ICE Clear Europe's clearing risk department maintains an effective EOD price discovery process and takes into account current market conditions by consulting with the trading advisory committee. The Commission therefore believes that the proposed rule change would help establish and maintain written policies and procedures reasonably designed to cover ICE Clear Europe's credit exposures to its participants by establishing

a risk-based margin system that marks participant positions to market and collects margin, including variation margin.

Therefore, for the above reasons the Commission finds that the proposed rule change is consistent with Rule 17Ad-22(e)(6)(ii).<sup>43</sup>

D. Consistency with Rule 17Ad-22(e)(6)(iv)

Rule 17Ad-22(e)(6)(iv) requires that ICE Clear Europe establish, implement, maintain and enforce written policies and procedures reasonably designed to cover its credit exposures to its participants by establishing a risk-based margin system that uses reliable sources of timely price data and uses procedures and sound valuation models for addressing circumstances in which pricing data are not readily available or reliable.<sup>44</sup>

As discussed above, the proposed rule change would help improve the pricing data that ICE Clear Europe uses in its margin system. Specifically, the proposed rule change would, as discussed above, enhance the computation of BOWs for single-name CDS instruments by amending the Price Discovery Policy to (1) compute a consensus BOW for each benchmark single-name instrument; (2) determine the final EOD BOW as the greater of an instrument's final systematic BOW and a dynamic BOW; and (3) eliminate the use of the ISDA CDS Standard Model from the computation of BOWs for single-name instruments. Because ICE Clear Europe uses BOWs to determine EOD price levels, the Commission believes that improvements in the collection and calculation of BOWs would improve the accuracy and reliability of ICE Clear Europe's EOD price levels. Finally, because ICE Clear Europe uses its EOD price levels to mark participant

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<sup>43</sup> 17 CFR 240.17Ad-22(e)(6)(ii).

<sup>44</sup> 17 CFR 240.17Ad-22(e)(6)(iv).

positions to market and establish and collect margin, including variation margin, the Commission believes that the proposed rule change would help ensure that the ICE Clear Europe's margin system uses reliable sources of timely price data.

Therefore, for the above reasons the Commission finds that the proposed rule change is consistent with Rule 17Ad-22(e)(6)(iv).<sup>45</sup>

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<sup>45</sup> 17 CFR 240.17Ad-22(e)(6)(iv).

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 Act<sup>46</sup> and Rules 17Ad-22(e)(2)(i), (e)(6)(ii), and (e)(6)(iv) thereunder.<sup>47</sup>

IT IS THEREFORE ORDERED pursuant to Section 19(b)(2) of the Act<sup>48</sup> that the proposed rule change (SR-ICEEU-2018-009) be, and hereby is, approved.<sup>49</sup>

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>50</sup>

Eduardo A. Aleman  
Assistant Secretary

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<sup>46</sup> 15 U.S.C. 78q-1.

<sup>47</sup> 17 CFR 240.17Ad-22(e)(2)(i), (e)(6)(ii), and (e)(6)(iv).

<sup>48</sup> 15 U.S.C. 78s(b)(2).

<sup>49</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>50</sup> 17 CFR 200.30-3(a)(12).