

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-66916; File No. SR-ICC-2012-03)

May 3, 2012

Self-Regulatory Organizations; ICE Clear Credit LLC; Order Approving Proposed Rule Change to Reduce the Current Level of Risk Mutualization Among Clearing Participants and to Modify the Initial Margin Risk Model so That it is Easier for Clearing Participants to Measure their Recovery Rate Risk Exposure

I. Introduction

On March 8, 2012, ICE Clear Credit LLC (“ICC”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change SR-ICC-2012-03 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 March 26, 2012.³ The Commission received no comment letters regarding the proposal. For the reasons discussed below, the Commission is granting approval of the proposed rule change.

II. Description

This rule change permits ICC to make two modifications to its risk model for clearing credit default swaps (“CDS”) contracts. For the first modification (“Modification #1”), ICC is reducing the current level of risk mutualization among its clearing participants by modifying its initial margin model to collateralize the loss that would occur from the single name CDS that causes the greatest loss entering a state of default. For the second modification (“Modification #2”), ICC is modifying its initial margin model to make clearing participants’ risk requirements more transparent by removing the conditional recovery rate stress-scenarios and adding a new

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Securities Exchange Act Release No. 34-66631 (March 20, 2012), 77 FR 17536 (March 26, 2012).

standalone recovery rate sensitivity component that is computed by considering changes in recovery rate assumptions and their impact on the net asset value of the clearing portfolio.

ICC represents that Modification #1 will reduce the level of default resources held in ICC's mutualized guaranty fund and increase the level of default resources held in initial margin. ICC is implementing this by incorporating into its initial margin model the single name CDS that causes the greatest loss when entering a state of default (i.e., the single name CDS that results in the greatest amount of loss when stress-tested). This change collateralizes the loss that would occur from the single name CDS that causes the greatest loss entering a state of default. Consequently, the amount of uncollateralized loss that would result from the three single name CDS contracts causing the greatest cumulative losses when entering a state of default is reduced, thereby reducing the amount of required guaranty fund contributions from clearing participants. ICC represents that the decrease in the guaranty fund and the increase in initial margin requirements are not symmetrical. Instead, based upon current portfolios, ICC approximates that for every \$1 decrease to the guaranty fund there will be a corresponding increase to the initial margin requirements of approximately \$5.

ICC represents that Modification #2 will make it easier for clearing participants to evaluate the risk of their CDS clearing portfolio as measured by the impact of changing recovery rate assumptions. ICC is implementing this by removing the conditional recovery rate stress-scenarios and adding a new standalone recovery rate sensitivity component that is computed by considering changes in recovery rate assumptions that impact the net asset value of the CDS clearing portfolio. ICC argues that by making it easier for market participants to measure their risk, Modification #2 is consistent with the requirements of Section 17A of the Act and the rules and regulations thereunder applicable to it.

III. Discussion

Section 19(b)(2)(C) of the Act⁴ 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 Act⁵ requires, among other things, that the rules of a clearing agency be designed to remove impediments to and perfect the mechanism of a national system for the prompt and accurate clearance and settlement of securities transactions and to assure the safeguarding of securities and funds in the custody or control of the clearing agency or for which it is responsible.

Modification #1 will require each clearing participant to collateralize its greatest single name CDS exposure that it creates for other clearing participants. As such, Modification #1 will require clearing participants to bear a greater portion of the loss resulting from their default and also increases the amount of risk requirements ICC collects, thereby assuring the safeguarding of securities and funds in the custody or control of ICC or for which it is responsible. Modification #2 will require ICC to separately estimate requirements using various recovery rate assumptions and improve the ability of clearing participants to identify the impact of considering various changes to recovery rate assumptions on the net asset value of their CDS clearing portfolios, thereby removing an impediment to the prompt and accurate clearance and settlement of securities transactions.

⁴ 15 U.S.C. 78s(b)(2)(C).

⁵ 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 Act⁶ and the rules thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,⁷ that the proposed rule change (File No. SR-ICC-2012-03) be, and hereby is, approved.⁸

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁹

Kevin O'Neill
Deputy Secretary

⁶ 15 U.S.C. 78q-1.

⁷ 15 U.S.C. 78s(b)(2).

⁸ 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).

⁹ 17 CFR 200.30-3(a)(12).