

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-73534; File No. SR-ICC-2014-14)

November 5, 2014

Self-Regulatory Organizations; ICE Clear Credit LLC; Order Approving Proposed Rule Change to Add Rules Related to the Clearing of Standard Western European Sovereign CDS Contracts

I. Introduction

On August 25, 2014, ICE Clear Credit LLC (“ICC”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change SR-ICC-2014-14 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 September 4, 2014.³ The Commission did not receive comments on the proposed rule change. On October 17, 2014, the Commission extended the time period in which to either approve, disapprove, or institute proceedings to determine whether to disapprove the proposed rule change to December 3, 2014.⁴ For the reasons discussed below, the Commission is approving the proposed rule change.

II. Description of the Proposed Rule Change

ICC proposes to amend Chapter 26 of the ICC Clearing Rules (“Rules”) to add Subchapter 26I and to amend the ICC Risk Management Framework to provide for the clearance of Standard Western European Sovereign (“SWES”) credit default swap (“CDS”) contracts,

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Securities Exchange Act Release No. 34-72941 (Aug. 28, 2014), 79 FR 52794 (Sep. 4, 2014) (SR-ICC-2014-14).

⁴ Securities Exchange Act Release No. 34-73384 (Oct. 17, 2014), 79 FR 63453 (Oct. 23, 2014) (SR-ICC-2014-14).

specifically the Republic of Ireland, the Italian Republic, the Portuguese Republic, and the Kingdom of Spain (collectively, the “SWES Contracts”).

ICC states that the proposed rule change is dependent on the approval and implementation of the proposed rule change contained in ICC rule filing SR-ICC-2014-11,⁵ amending the ICC Rules, Restructuring Procedures, and Risk Management Framework to incorporate references to the revised Credit Derivatives Definitions, as published by the International Swaps and Derivatives Association, Inc. (“ISDA”) on February 21, 2014 (the “2014 ISDA Definitions”) and that SWES Contracts will only be offered on the 2014 ISDA Definitions.⁶

ICC represents that the SWES Contracts have similar terms to the Standard North American Corporate Single Name CDS contracts (“SNAC Contracts”) currently cleared by ICC and governed by Subchapter 26B of the ICC Rules, the Standard Emerging Sovereign CDS contracts (“SES Contracts”) currently cleared by ICC and governed by Subchapter 26D of the ICC Rules, and the Standard European Corporate Single Name CDS contracts (“SDEC Contracts”) currently cleared at ICC and governed by Subchapter 26G of the ICC Rules. Accordingly, ICC states that the proposed rules found in Subchapter 26I largely mirror the ICC Rules for SNAC Contracts in Subchapter 26B, SES Contracts in Subchapter 26D, and SDEC Contracts in Subchapter 26G, with certain modifications that reflect differences in terms and

⁵ See Securities Exchange Act Release No. 34-72701 (Jul. 29, 2014); 79 FR 45565 (Aug. 5, 2014) (SR-ICC-2014-11).

⁶ ICC rule filing SR-ICC-2014-11 was approved by the Commission on September 5, 2014. See Securities Exchange Act Release No. 34-73007 (Sep. 5, 2014), 79 FR 54331 (Sep. 11, 2014) (SR-ICC-2014-11).

market conventions between those contracts and SWES Contracts.⁷ SWES Contracts will be denominated in United States Dollars.

ICC represents that clearing SWES Contracts will not require any changes to ICC's operational procedures, as the SWES Contracts operate similarly to the Standard Emerging European and Middle Eastern Sovereign Single Names, currently cleared by ICC. The addition of the SWES Contracts to ICC's product offering requires risk specific changes to the ICC Risk Management Framework, which are described below.

ICC's Risk Management Framework would be revised to incorporate additional model features designed to generalize the currently established Specific Wrong Way Risk ("SWWR") Initial Margin requirement. ICC states that the proposed changes to the ICC Risk Management Framework would generalize the SWWR relative to General Wrong Way Risk ("GWWR"), and that this generalization of Wrong Way Risk ("WWR") is introduced to account for additional risk present in CDS instruments whose reference entities exhibit a high level of correlation with those Clearing Participants clearing the relevant name, or with an entity that is guaranteed by, or affiliated with, those Clearing Participants. ICC states that, accordingly, the offering of SWES Contracts introduces potential GWWR in the form of country/region of domicile WWR. ICC notes that examples of GWWR related to SWES include but are not limited to a Clearing Participant selling protection on its country of domicile, or a European domiciled Clearing Participant selling protection on European sovereign reference entities. To address such risks, ICC proposes to establish an additional Jump To Default Risk ("JTDR") requirement.

Accordingly, the Risk Management Framework contains revisions to the calculation of the portfolio JTDR requirement. Specifically, the calculations have been updated to incorporate

⁷ The proposed changes to the ICC Rules are described in further detail in the notice of filing of the proposed rule change. See supra note 3.

the concept of WWR as described below in reference to the quantitative and qualitative approaches. ICC represents that these proposed revisions would have no material impact on the size of the Guaranty Fund.

ICC's proposed changes adopt a combination of qualitative and quantitative approaches to capture GWWR. Under the revised ICC Risk Management Framework, an additional contribution to the JTDR requirement would be required when Clearing Participants sell protection on SWES reference entities exhibiting a high degree of association with itself (based on a quantitative approach established by ICC to determine the degree of correlation) or by virtue of selling protection on its country of domicile (based on a qualitative approach established by ICC to determine a Clearing Participant's country of domicile).

For the qualitative case (i.e., a Clearing Participant selling protection on its own country of domicile), ICC would require full collateralization of the additional Jump To Default ("JTD") loss. In determining a Clearing Participants' country of domicile, ICC refers to the International Organization for Standardization ("ISO") country code for the issuer's ultimate parent country of risk. ICC states that the ISO methodology considers management location, country of primary listing, country of revenue and reporting currency of the issuer.

The quantitative approach applies to the additional risk arising from Clearing Participants selling protection on SWES reference entities, other than the Clearing Participant's country of domicile, on which the Clearing Participant's domicile has a high degree of correlation. If the additional SWES JTD losses and the dependence levels breach specific quantitative threshold amounts, additional GWWR collateralization would be required. The additional collateralization is a function of the level of correlation between the Clearing Participants and the SWES reference entities and will become more conservative as the level of correlation increases.

As a result of these enhancements to the ICC Risk Management Framework, Rule 26D-309 (Acceptance of SES Contracts by ICE Clear Credit), part (c) would be revised to remove language which prohibits the acceptance of Trades for clearance and settlement if at the time of submission or acceptance of the Trade or at the time of novation the Participant submitting the Trade is domiciled in the country of the Eligible Standard Emerging Sovereign (“SES”) Reference Entity for such SES contract. ICC states that the new GWWR methodology will apply to all sovereign contracts cleared by ICC, including SES contracts.

III. Discussion and Commission Findings

Section 19(b)(2)(C) of the Act⁸ 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 Act⁹ 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.

The Commission finds that the proposed revisions to the ICC Rules and Risk Management Framework are consistent with the requirements of Section 17A of the Act¹⁰ and the rules and regulations thereunder applicable to ICC. Specifically, the Commission believes that the proposed rules in Subchapter 26I to allow for the clearance of SWES Contracts, in

⁸ 15 U.S.C. 78s(b)(2)(C).

⁹ 15 U.S.C. 78q-1(b)(3)(F).

¹⁰ 15 U.S.C. 78q-1.

conjunction with existing ICC Rules and procedures applicable to the clearing of CDS contracts, are designed to promote the prompt and accurate clearance and settlement of securities transactions, consistent with Section 17A(b)(3)(F) of the Act.¹¹

Additionally, the Commission believes that the proposed revisions to ICC's Risk Management Framework to address the wrong way risk associated with clearing SWES Contracts are designed to promote the prompt and accurate clearance and settlement of securities 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, consistent with Section 17A(b)(3)(F) of the Act.¹² Specifically, the proposed changes to the ICC Risk Management Framework would require additional collateralization in the form of initial margin from Clearing Participants that sell protection on SWES reference entities exhibiting a high degree of association with itself or that sell protection on its country of domicile. These proposed margin model enhancements will provide additional resources to ICC to address the credit risks associated with the correlation between the risk of default of an underlying sovereign and the risk of default of a Clearing Participant that has written credit protection through SWES Contracts on such sovereign. Accordingly, the Commission believes that the proposed changes to the Risk Management Framework, in combination with ICC's existing rules and procedures related to margin and guaranty fund, are reasonably designed to meet the requirements of Rules 17Ad-22(b)(1) - (3)¹³ related to the measurement and management of credit exposures, margin requirements, and the maintenance of

¹¹ 15 U.S.C. 78q-1(b)(3)(F).

¹² Id.

¹³ 17 CFR 240.17Ad-22(b)(1) - (3).

sufficient financial resources required for a registered clearing agency acting as a central counterparty for security-based swaps.

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 Act¹⁴ and the rules and regulations thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹⁵ that the proposed rule change (SR-ICC-2014-14) be, and hereby is, approved.¹⁶

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁷

Kevin M. O'Neill
Deputy Secretary

¹⁴ 15 U.S.C. 78q-1.

¹⁵ 15 U.S.C. 78s(b)(2).

¹⁶ 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).

¹⁷ 17 CFR 200.30-3(a)(12).