

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-74563; File No. SR-ICC-2015-004)

March 23, 2015

Self-Regulatory Organizations; ICE Clear Credit LLC; Notice of Filing of Proposed Rule Change Relating to Physical Settlement of CDS Contracts

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on March 11, 2015, ICE Clear Credit LLC (“ICC” or the “clearinghouse”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II and III below, which Items have been prepared primarily by ICC. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

The purpose of the proposed rule change is to amend ICC rules to modify the terms and conditions for physical settlement of cleared CDS Contracts, and to adopt certain new delivery procedures relating to physical settlement.

II. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, ICC included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. ICC has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of these statements.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

ICC submits proposed amendments to the ICC Clearing Rules (“ICC Rules”) relating to physical settlement of CDS Contracts. Upon the occurrence of a credit event under a cleared CDS Contract, the contract is typically settled in cash in accordance with the terms of the ICC Rules, which incorporate the applicable ISDA Credit Derivatives Definitions (the “ISDA Definitions”) and the market-standard credit default swap auction methodology for determining the cash settlement price. However, in certain circumstances, such as where the Credit Derivatives Determinations Committee decides not to hold a cash settlement auction for a particular credit event, or such an auction is cancelled under the terms of the auction methodology (including because of a failure to determine the auction settlement price), the CDS Contracts provide for a fallback settlement method of physical settlement. Under physical settlement of a CDS contract generally, the protection buyer will be entitled to deliver one or more qualifying deliverable obligations to the protection seller, in which case the protection seller will be required to pay the protection buyer a defined physical settlement amount. Under the current ICC Rules, if physical settlement applies,³ the clearinghouse will match clearing participants (“Participants”) that are protection buyers with Participants that are protection sellers in the relevant contract, and the two Participants will be responsible for effecting physical settlement between them. ICC does not itself perform or guarantee performance of physical settlement between the matched Participants. Once matching occurs, the contract is purely a bilateral contract between the matched Participants, and the clearinghouse has no further rights or obligations with respect to the contract. ICC does, however, collect and hold physical

³ ICC notes that to date, physical settlement has not been necessary for any of the CDS Contracts cleared by ICC.

settlement margin as collateral agent on behalf of the protection buyer to secure the protection seller's obligations to the protection buyer under physical settlement.

At the request of its Participants, and following extensive consultation with them, ICC proposes to amend the ICC Rules relating to physical settlement such that the clearinghouse will be responsible for financial performance of physical settlement. ICC understands that Participants and other market participants view the current approach, in which cash settlement of credit events is guaranteed by the clearinghouse but physical settlement is not, as creating a potentially anomalous result in the unlikely case that physical settlement may apply. The application of physical settlement would be a circumstance that is generally not within any Participant's control, and under the current rules may expose Participants to a significantly different credit risk profile than under cash settlement (where the Participant is exposed to the credit of the clearinghouse). In light of these discussions, ICC has determined that it is appropriate to extend the clearing guarantee to the financial performance of physical settlement. ICC notes that under the amended approach, it would still require payments and deliveries in the ordinary course under physical settlement to be made directly between the matched buying Participant and selling Participant, with the clearinghouse only being obligated to make direct payments in the case of certain defined settlement failure scenarios. ICC believes that this proposed rule change will further the general policy goals of central clearing for CDS transactions, and is consistent with the clearinghouse's financial resources, risk management procedures and operational capabilities.⁴

ICC proposes to make certain amendments to Chapters 1, 4, 5, 21 and 22 of the ICC Rules. ICC also proposes to adopt a related set of Delivery Procedures and Physical Settlement

⁴ ICC notes that a substantially similar approach to physical settlement is used in the ICE Clear Europe Limited CDS clearing service.

and Notices Terms. ICC also proposes to make certain related and conforming changes to its Risk Management Framework. All capitalized terms not defined herein are defined in the ICC Rules.

In Chapter 1 of the ICC Rules, the definition of “Client-Related Initial Margin” has been amended so that it now includes Physical Settlement Margin collected with respect to Client-Related Positions. As discussed below, such Physical Settlement Margin will now secure the obligations of a Participant to ICC in connection with physical settlement. Similarly, in Rule 403, the definition of “Physical Settlement Margin” has been amended to refer to such obligations to ICC (as opposed to the obligations to the matched Participant under the current ICC Rules). In Rule 502(b), a conforming reference to Physical Settlement Margin has been updated. A conforming change is also made in Rule 2101-02(a)(iv).

In Chapter 22 (which covers physical settlement), a new Rule 2200 is added with definitions relating to the revised physical settlement provisions, including “Matched Delivery Buyer” and “Matched Delivery Seller,” and the related terms “Matched Delivery Contract,” “Matched Delivery Buyer Contract,” “Matched Delivery Seller Contract” and “MP Delivery Amount.” As discussed below, these terms are used in connection with the matching of buying Participants and selling Participants in the revised settlement procedures. A new definition of “Asset Package Delivery Notice” has also been added to address notices in connection with Asset Package delivery under the 2014 ISDA Credit Derivatives Definitions (the “2014 ISDA Definitions”).

Rule 2201(a), which provides for matching of buying Participants and selling Participants into a Matched Delivery Pair in the case of physical settlement, has been revised to address scenarios where a Participant’s CDS contracts must be split and matched with multiple other

Participants for purposes of physical settlement. Conforming changes to use applicable defined terms (such as Relevant Restructuring Credit Event) have also been made. Rule 2201(b), which addresses delivery of certain notices between a Matched Delivery Pair, has been revised to include references to Asset Package Delivery Notices. Rule 2201(c) has been deleted at the request of Participants as being inconsistent with the terms of uncleared CDS and unnecessary in light of the provisions of the ISDA Definitions and Rule 2202.

Rule 2202, which addresses resolution of disputes related to permissible deliverable obligations, has been revised to incorporate the concept of Asset Package Delivery under the 2014 ISDA Definitions, as well as related concepts of Prior Deliverable Obligations, Package Observable Bonds and Asset Package Delivery Notices. Rules 2202(b) and (c) have also been revised to address the consequences of a selling Participant's refusal to accept delivery of a particular obligation, including for the offsetting transaction between ICC and the buying Participant.

Rule 2203 has been replaced with new provisions addressing the clearinghouse's role in physical settlement. When a Matched Delivery Pair is established, the CDS Contract between the Matched Delivery Buyer and ICC is referred to as the Matched Delivery Buyer Contract, and the corresponding CDS Contract between ICC and the Matched Delivery Seller is referred to as the Matched Delivery Seller Contract. Under the revised physical settlement approach, ICC remains party to each such contract, but requires certain notices, payments and deliveries to take place directly between the Matched Delivery Buyer and Matched Delivery Seller. Accordingly, under Rule 2203(a), for each Matched Delivery Buyer Contract, ICC designates the Matched Delivery Seller to receive on ICC's behalf notices and deliveries from the Matched Delivery Buyer and to make payments on ICC's behalf to the Matched Delivery Buyer. Similarly, under

Rule 2203(b), for each Matched Delivery Seller Contract, ICC designates the Matched Delivery Buyer to deliver on ICC's behalf notices and deliveries to the Matched Delivery Seller, and to receive on ICC's behalf payments from the Matched Delivery Seller. The result is that notices, payments and deliveries will be made directly between the Matched Delivery Buyer and Matched Delivery Seller, in satisfaction of the parties and ICC's respective obligations under both the Matched Delivery Buyer Contract and Matched Delivery Seller Contract. Rule 2203(c) further clarifies that the exercise of rights by Matched Delivery Buyer against ICC will be deemed the exercise by ICC of the corresponding rights against Matched Delivery Seller, and vice versa. Rules 2203(d) and (e) provide for copies of relevant notices to be provided to ICC, as well as notice of the completion of settlement between the Matched Delivery Buyer and Matched Delivery Seller. Rule 2203(f) clarifies the obligations of the respective parties to a Matched Delivery Contract, and addresses a scenario where an Asset Package being delivered is deemed to have a value of zero under the 2014 ISDA Definitions. Rule 2203(g) allocates costs and expenses that may be incurred by ICC in connection with physical settlement.

Rule 2204, as revised, addresses physical settlement of certain deliverable obligations that do not settle in the ordinary course on a delivery-versus-payment basis ("Non-DVP Obligations"). The rule establishes a procedure under which the Matched Delivery Seller pays the physical settlement amount owed to ICC, which in turn will not pay such amount to the Matched Delivery Buyer until ICC receives notice that the obligation has been received by the Matched Delivery Seller from the Matched Delivery Buyer. If the obligation is not delivered, the physical settlement amount is returned to the Matched Delivery Seller.

Rule 2205 addresses settlement failures by the Matched Delivery Seller or Matched Delivery Buyer. Under subsection (a), if the Matched Delivery Seller fails to pay the physical

settlement amount when due, the Matched Delivery Buyer Contract will be cash settled as between the Matched Delivery Buyer and ICC. ICC thus will not be obligated to take delivery of the relevant deliverable obligations (and dispose of them in a situation where the Matched Delivery Seller has failed to perform), but will compensate the Matched Delivery Buyer for the value of the Matched Delivery Buyer Contract through the cash settlement process. Pursuant to subsection (b), ICC may, in addition to its other default remedies, terminate the Matched Delivery Seller Contract, in which case the Matched Delivery Seller will owe ICC an amount equal to the cash settlement amount ICC paid the Matched Delivery Buyer, together with other losses and expenses incurred by ICC as a result of the failure. Rule 2205(c) provides that, consistent with the terms of the ISDA Definitions applicable to a protection buyer generally, any failure by ICC to deliver any deliverable obligations to the Matched Delivery Seller (including as a result of a failure by the Matched Delivery Buyer to make a delivery) will not constitute a default by ICC, and the Matched Delivery Seller's sole remedy will be as set forth in the Matched Delivery Seller Contract (which may include, for example, buy-in remedies of the Matched Delivery Seller). ICC will not have any obligation to purchase or acquire deliverable obligations (other than in settlement of the Matched Delivery Buyer Contract) in order to settle the Matched Delivery Seller Contract. This is consistent with the clearinghouse's guarantee of finance performance, but not actual delivery. In the event of a delivery failure by a Matched Delivery Buyer, such party will be liable to ICC for any costs incurred by ICC in settling the corresponding Matched Delivery Seller Contract (in addition to ICC's other remedies for a default).

Rule 2206 covers certain other, non-default scenarios in which physical settlement fails to occur. Under Rule 2206(a) and (b), if physical settlement of the Matched Buyer Delivery

Contract does not occur because the deliverable obligation is in less than the relevant minimum denomination or the Matched Delivery Seller is not a permitted transferee of the obligation, the failure will be treated as an illegality or impossibility outside of the parties' control, which will result in cash settlement⁵ under the ISDA Definitions. In this and other scenarios where a cash settlement fallback applies, the same cash settlement amount will apply to both the Matched Delivery Buyer Contract and Matched Delivery Seller Contract under Rule 2206(c). Similarly, in the case of a buy-in, the same buy-in price will apply to both contracts. Rule 2206(d) provides for cash settlement of both the Matched Delivery Buyer Contract and Matched Delivery Seller Contract in certain cases where delivery does not occur between the Matched Delivery Buyer and the customer for which it is acting. Rule 2206(e) specifies the date of any cash settlement and provides for notice of the relevant amount owed.

Rule 2207(a) provides for certain standard representations and related provisions for physical settlement in the ISDA Definitions to apply as between the Matched Delivery Buyer and Matched Delivery Seller, and clarifies ICC's authority to designate a Participant to make or receive physical settlement on its behalf as provided in Rules 2203 and 2204 for purposes of Section 9.2(c)(iv) of the 2003 Definitions or Section 11.2(c)(iv) of the 2014 Definitions, even though the Participant is not its Affiliate. Rule 2207(b) clarifies certain procedures for obtaining price quotations for the relevant deliverable obligations in the event that a cash settlement fallback applies.

Rule 2208 allows the Matched Delivery Buyer and Matched Delivery Seller to settle their rights and obligations as to physical settlement through an alternative arrangement agreed

⁵ Cash settlement in this context is different from the auction cash settlement that normally applies to CDS contracts under the ISDA Definitions, and is based on price quotations obtained by the relevant party to the contract for the obligation or obligations that cannot be delivered.

between them (referred to as a “CADP”), in lieu of settlement pursuant to Chapter 22 of the Rules. If they so agree, ICC will have no obligation in respect of such alternative arrangement.

Rule 2209(a) and (c) provide that margin (including physical settlement margin) will continue to be called and held through settlement. Rule 2209(b) provides that ICC will apply physical settlement margin to satisfy the Matched Delivery Seller’s obligation to pay the physical settlement amount, and call such seller for any shortfall.

ICC also proposes to adopt Delivery Procedures that further specify certain operational and other details for the physical settlement process. Paragraph 1 provides certain definitions used in the Delivery Procedures. Paragraph 3.2 sets out certain requirements for providing notices in connection with physical settlement. Paragraphs 3.3(a)-(e) establish the procedures and timetable for ICC to allocate Matched Delivery Pairs and notify Participants accordingly. Paragraph 3.3(g) addresses additional procedures concerning delivery of notices by Participants in connection with physical settlement, including as to relevant notice deadlines, requirements for providing copies of notices to the clearinghouse, treatment of late notices and procedures for disputes involving notices. Paragraph 4 of the Delivery Procedures specifies certain deadlines in connection with the physical settlement of Non-DVP Obligations under Rule 2204. Paragraph 5 specifies the deadline for notices that parties have elected a CADP.

ICC also proposes to adopt a set of Physical Settlement and Notices Terms (“Notices Terms”) with respect to physical settlement. The Notices Terms are intended to set forth in a uniform way certain matters between a Participant and its customer in connection with physical settlement, including delivery of physical settlement notices and delivery and receipt of deliverable obligations as between the Participant and its customer. The Notices Terms also address the operation of certain cash settlement and other fallbacks as between the Participant

and its customer. The Notices Terms do not bind ICC and do not form part of the ICC Rules or ICC Procedures. The Notices Terms are published for the convenience and use of Participants and their customers, and are designed to be incorporated by reference in customer clearing documentation. However, a Participant and its customer may agree to vary the Notices Terms as between them.

ICC also proposes to make certain changes to its Risk Management Framework to accommodate the changes relating to physical settlement that are being made to the Rules and procedures as set forth herein. As revised, the Risk Management Framework reflects the clearinghouse's obligations in respect of physical settlement as provided in the amended Rules and procedures. It sets out the steps in the physical settlement process to be taken by the clearinghouse if physical settlement applies, including the matching of Participants into Matched Delivery Pairs, consistent with the Rules and procedures. The revisions also address the calculation, collection and use of margin (including physical settlement margin) where physical settlement applies.

Section 17A(b)(3)(F) of the Act⁶ requires, among other things, that the rules of a clearing agency be designed to promote the prompt and accurate clearance and settlement of securities transactions, and to the extent applicable, derivative agreements, contracts and transactions and to comply with the provisions of the Act and the rules and regulations thereunder. ICC believes that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to ICC, in particular, Section 17(A)(b)(3)(F)⁷ and Rule 17Ad-22,⁸ because the proposed rule change will assure the prompt and accurate clearance and

⁶ 15 U.S.C. 78q-1(b)(3)(F).

⁷ Id.

⁸ 17 CFR 240.17Ad-22.

settlement of securities transactions and derivatives agreements, contracts, and transactions. Specifically, ICC believes that the proposed amendments will enhance the clearance and settlement of CDS transactions in circumstances where physical settlement applies. Although physical settlement applies only rarely, and as a fallback to the normal procedure for auction cash settlement, ICC and its Participants believe that the amendments will benefit the CDS market generally by making the physical settlement process more robust and providing greater certainty around the physical settlement process. ICC proposes to extend its clearing guarantee to the financial performance of physical settlement, which eliminates the existing gap in coverage where contracts go to physical settlement and avoids exposing Participants to the direct credit of other Participants in the case of physical settlement. At the same time, ICC has designed the revised procedures so that it is not itself required to make or take delivery of underlying deliverable obligations. In the ordinary course, payments and deliveries (and related notices) will be made directly between the matched buying and selling Participants. In the case of a settlement failure, the clearinghouse's obligations will be settled in cash, avoiding the need for the clearinghouse to obtain or dispose of deliverable obligations. In ICC's view, this allows it to appropriately limit and manage its risks with respect to physical settlement of cleared CDS contracts. As a result, ICC believes that the amendments will promote the accurate clearing and settlement of CDS contracts, and are therefore consistent with the requirements of Section 17A(b)(3)(F) of the Act.⁹

In addition, the amendments are consistent with the requirements of Rule 17Ad-22.¹⁰ In particular, Rule 17Ad-22(d)(15)¹¹ requires that ICC "state to its participants the clearing

⁹ 15 U.S.C. 78q-1(b)(3)(F).

¹⁰ 17 CFR 240.17Ad-22.

¹¹ 17 CFR 240.17Ad-22(d)(15).

agency's obligations with respect to physical deliveries and identify and manage the risks from these obligations." As discussed above, revised chapter 22 of the Rules clearly states ICC's obligations with respect to physical settlement of CDS Contracts. The revised Rules establish the clearinghouse's responsibility for financial performance of physically settled contracts, while establishing the procedures for settlement in the ordinary course to take place directly between the buying Participant and the selling Participant. The Rules also establish the procedures to be followed in the case of a settlement failure and the responsibilities of the relevant Participants and ICC with respect thereto, and provide a mechanism for ICC to effect settlement in cash without having to acquire or dispose of the underlying deliverable obligations. In ICC's view, these arrangements permit it to appropriately manage the risks to the clearinghouse from the physical settlement obligations it would undertake under the proposed amendments, and are therefore consistent with the requirements of Rule 17Ad-22(d)(15).¹²

In terms of financial resources, ICC will continue to collect initial and mark-to-market margin for CDS Contracts through the completion of physical settlement, and does not propose to change its margin methodology with respect thereto in connection with these amendments. In addition, ICC will collect physical settlement margin to cover the specific obligations of Participants to the clearinghouse with respect to physical settlement. In ICC's view, its financial resources will as a result be sufficient to support its clearing operations, including under the amended physical settlement procedures, in a manner consistent with the requirements of Rule 17Ad-22(d)(2).¹³

In terms of default management, the amendments provide additional procedures for addressing settlement failures in the physical settlement process, in a manner that provides

¹² Id.

¹³ 17 CFR 240.17Ad-22(d)(2).

financial protection to non-defaulting Participants while avoiding the need for the clearinghouse to make or take physical delivery. ICC believes that these additional provisions, together with its existing default management rules and procedures, will permit it to take timely action to contain losses and liquidity pressures and continue meeting its obligations in the case of a default, including in connection with physical settlement, within the meaning of Rule 17Ad-22(d)(11).¹⁴

ICC also believes that its operational systems and capabilities are sufficient to support the changes to physical settlement. As discussed above, ICC proposes to adopt Delivery Procedures that would specify certain key operational aspects of the physical settlement process. These procedures, as well as related systems and arrangements, address relevant sources of operational risk in the physical settlement process and are designed to minimize such risks, within the meaning of Rule 17Ad-22(d)(4).¹⁵

B. Self-Regulatory Organization's Statement on Burden on Competition

ICC does not believe the proposed amendments would have any impact, or impose any burden, on competition not necessary or appropriate in furtherance of the purpose of the Act. The amendments will apply uniformly across all Participants. Although physical settlement is expected to be a remote circumstance, the amendments are intended to extend the benefit of the clearing guarantee to that process in the event it occurs, and therefore would generally be expected to benefit all market participants. Although ICC may collect additional physical settlement margin in connection with physical settlement, such margin is, in ICC's view, necessary to protect the operation of the clearinghouse and will affect all Participants with positions that go to physical settlement. In other respects, ICC does not anticipate that these enhancements will materially affect the cost of clearing for Participants or other market

¹⁴ 17 CFR 240.17Ad-22(d)(11).

¹⁵ 17 CFR 240.17Ad-22(d)(4).

participants. In addition, ICC is not otherwise proposing to change its standards for access to the clearinghouse or the terms and conditions of cleared contracts (which already provide for physical settlement in these limited circumstances, but without the benefit of the clearinghouse guarantee). As a result, ICC does not believe the amendments will adversely affect the ability of Participants or other market participants to continue to clear CDS contracts. ICC also does not believe the enhancements will limit the availability of clearing in CDS products for Participants or their customers or otherwise limit market participants' choices for selecting clearing services in CDS. Therefore, ICC does not believe the proposed rule change imposes any burden on competition that is not appropriate in furtherance of the purpose of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others

Written comments relating to the proposed rule change have not been solicited or received. ICC will notify the Commission of any written comments received by ICC.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period up to 90 days (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve or disapprove the proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-ICC-2015-004 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-ICC-2015-004. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filings will also be available for inspection and copying at the principal office of ICE Clear Credit and on ICE Clear Credit's website at <https://www.theice.com/clear-credit/regulation>.

All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-ICC-2015-004 and should be submitted on or before [Commission to insert date 21 days from publication in the Federal Register].

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

Brent J. Fields
Secretary

¹⁶ 17 CFR 200.30-3(a)(12).