

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34-85776; File No. SR-ICEEU-2019-006)

May 3, 2019

Self-Regulatory Organizations; ICE Clear Europe Limited; Order Approving Proposed Rule Change Relating to Amendments to the CDS Risk Management Model Description

I. Introduction

On March 13, 2019, 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”)¹, and Rule 19b-4 thereunder,² a proposed rule change to make certain amendments to its CDS Risk Model Description document to incorporate risk model enhancements related to the single name credit default swap (“CDS”) liquidity charge methodology. The proposed rule change was published for comment in the Federal Register on March 22, 2019.³ The Commission did not receive comments on the proposed rule change. For the reasons discussed below, the Commission is approving the proposed rule change.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Securities Exchange Act Release No. 85350 (March 18, 2019), 84 FR 10869 (March 22, 2019) (SR-ICEEU-2019-006) (“Notice”).

II. Description of the Proposed Rule Change

ICE Clear Europe proposes a revised approach to computing single name CDS liquidity charges.⁴ ICE Clear Europe might incur additional costs to unwind positions in the event of a clearing member default. Therefore, the ICE Clear Europe CDS risk model includes a provision to account for the additional liquidation cost due to the exposure to Bid/Offer Width (“BOW”). This provision is called a liquidation charge and such charges are computed separately for single names and indices.

ICE Clear Europe proposes to introduce minimum instrument liquidity requirements independent of instrument maturities.⁵ ICE Clear Europe’s current spread-based liquidity charge approach features instrument liquidity requirements that decay with time to maturity for fixed credit spread levels.⁶ The proposed rule change introduces minimum liquidity requirements for individual instruments, independent of time to maturity for the considered instruments, and thus establishes minimum liquidity charges that do not decay over time as contract maturity is approached.⁷ The proposed calculation for single name CDS liquidity charges at the instrument level incorporates a price-based bid-offer width floor component to provide stability and anti-procyclicality requirements, as well as a dynamic spread-based BOW component to reflect the additional risk associated with distressed market conditions.⁸ The values of such price-based

⁴ Capitalized terms not otherwise defined herein shall have the meanings given to them in the CDS Policies or ICE Clear Europe Rulebook.

⁵ Notice, 84 FR at 10869.

⁶ Id.

⁷ Id.

⁸ Id.

BOW and spread-based BOW are fixed factors, which are subject to at least monthly reviews and updates by ICE Clear Europe Risk Management Department with consultation with the Risk Working Group.⁹

ICE Clear Europe proposes other enhancements to the liquidity charge calculation at the single name level.¹⁰ The current liquidity charge approach at the single name level accounts for the liquidation cost across the curve. All positions are aggregated and priced at each maturity interval separately as a synthetic forward CDS instrument. This current approach introduces potential sub-additivity at the single name level, as it may result in a higher liquidity charge than the sum of the single name instrument requirements.¹¹

Under the proposed calculation, liquidity charges at the single name level will be computed by first calculating the liquidity requirements for each individual instrument position in the portfolio, and then summing all instrument liquidity requirements for positions with the same directionality, *i.e.* bought or sold protection.¹² The liquidity charge requirements at the single name level will be the greatest liquidity requirement associated with either the sum of all bought protection position liquidity requirements, or the sum of all sold protection position liquidity requirements.¹³ Under this proposed approach, the portfolios' liquidity charge cannot

⁹ Id.

¹⁰ Id.

¹¹ Id.

¹² Id.

¹³ Id.

exceed the sum of the individual instrument's requirements.¹⁴ There are no changes to the liquidity charge calculation at the portfolio level.¹⁵

ICE Clear Europe expects these enhancements will ensure more stable liquidity requirements for instruments across the curve and simplify ICE Clear Europe's liquidity charge methodology.¹⁶ As stated above, the current single name level liquidity requirements are based on forward CDS spread levels and are, in general, more difficult to calculate as forward spread levels are not observable across the curve.¹⁷ ICE Clear Europe, as part of its end-of-day price discovery process, provides end-of-day pricing data for instruments in which clients have open positions, which will, under the proposed approach, allow for easier replication for clients who wish to estimate liquidity charges for hypothetical and current positions.¹⁸

III. 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.¹⁹ For the reasons given below, the Commission finds that the proposed rule change

¹⁴ Id.

¹⁵ Id.

¹⁶ Id.

¹⁷ Id.

¹⁸ Id.

¹⁹ 15 U.S.C. 78s(b)(2)(C).

is consistent with Section 17A(b)(3)(F) of the Act²⁰ and Rules 17Ad-22(e)(4)(i) and (ii) and (e)(6)(i) and (v) thereunder.²¹

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.²²

As discussed above, the proposed rule change establishes minimum liquidity charges that do not decay over time as the contract maturity is approached. The Commission believes that this approach promotes a more conservative margin calculation approach by maintaining a minimum liquidity charge through an instrument's maturity. The Commission believes that this ensures that ICEEU requires clearing members to maintain sufficient margin to cover losses through the entire contract life rather than reducing these requirements as maturity approaches.

Further, as discussed above, under the proposed enhancements to the liquidity charge calculation, the portfolios' liquidity charge cannot exceed the sum of the individual instrument's requirements, which is a possibility under the current approach discussed above. The Commission believes that this proposal will in turn ensure more stable liquidity requirements for

²⁰ 15 U.S.C. 78q-1(b)(3)(F).

²¹ 17 CFR 240.17Ad-22(e)(4)(i) and (ii) and (e)(6)(i) and (v).

²² 15 U.S.C. 78q-1(b)(3)(F).

instruments across the curve and not require higher margins than necessary. Further, by summing all instrument liquidity requirements for positions with the same directionality rather than across the curve, the Commission believes that ICEEU is simplifying the process for clearing members as the approach is considered easier to calculate than the current approach, which is based on forward spread levels and hence more difficult to observe. Consequently, the Commission believes that this in turn will promote more accurate margin calculation by clearing members.

The Commission believes that the simplified and more conservative approach to calculating the liquidity charge for single name CDS discussed above will allow ICE Clear Europe's members to more easily calculate margin requirements in a way that promotes the prudent accumulation of financial resources.

Therefore, the Commission finds that the proposed rule change would provide ICE Clear Europe with the financial resources to ensure the prompt and accurate clearance and settlement of securities transactions and to assure the safeguarding of securities and funds which are in their custody or control. For these same reasons, the Commission also finds that the proposed rule change would, in general, protect investors and the public interest.

B. Consistency with Rule 17Ad-22(e)(4)(i) and (ii)

Rule 17Ad-22(e)(4)(i) and (ii) requires, in relevant part, that ICE Clear Europe establish, implement, maintain and enforce written policies and procedures reasonably designed to effectively identify, measure, monitor, and manage its credit exposures to participants and those arising from its payment, clearing, and settlement processes by maintaining sufficient financial resources to cover its credit exposure to each participant fully with a high degree of confidence

and maintain financial resources to enable it to cover the default of the two participant families that would potentially cause the largest aggregate credit exposure for ICE Clear Europe in extreme but plausible market conditions.²³

As discussed above, the Commission believes that the enhancements to the margin calculations related to single name CDS will help to maintain the soundness of ICE Clear Europe's margin requirements by promoting conservative, simple, and stable margin requirements that better capture the portfolio risks of single name CDS. The Commission believes that this in turn will help to ensure that ICE Clear Europe can maintain sufficient financial resources to withstand, at a minimum, a default by the two participant families to which it has the largest exposures in extreme but plausible market conditions.

C. Consistency with Rule 17Ad-22(e)(6)(i) and (v)

Rule 17Ad-22(e)(6)(i) requires, in relevant part, that ICE Clear Europe cover its credit exposures to its participants by establishing a risk-based margin system that, at a minimum considers, and produces margin levels commensurate with, the risks and particular attributes of each relevant product, portfolio, and market.²⁴ Rule 17Ad-22(e)(6)(v) requires, in relevant part, that ICE Clear Europe cover its credit exposures to its participants by establishing a risk-based margin system that, at a minimum uses an appropriate method for measuring credit exposure that accounts for relevant product risk factors and portfolio effects across products.²⁵

²³ 17 CFR 240.17Ad-22(e)(4)(i) and (ii).

²⁴ 17 CFR 240.17Ad-22(e)(6)(i).

²⁵ 17 CFR 240.17Ad-22(e)(6)(v).

As discussed above, the Commission believes that the enhancements to the risk model related to calculating the liquidity charges for single name CDS improves ICE Clear Europe's ability to avoid the losses that could result from the miscalculation of its credit exposures for particular products and thus produces margin levels more commensurate with the risks and particular attributes of each relevant product, portfolio, and market. In particular, by maintaining a minimum liquidity charge through an instrument's maturity, the Commission believes that clearing members will be better able to maintain sufficient margin to cover losses over time rather than reducing these requirements as maturity approaches. Moreover, as discussed above, by changing the liquidity charge requirements at the single name level so that the portfolios' liquidity charge cannot exceed the sum of the individual instrument's requirements, the Commission believes that this proposal will ensure more stable liquidity requirements for instruments and not require higher margins than necessary and that are commensurate with, the risks and particular attributes of each relevant product.

Therefore, for these reasons discussed above, the Commission finds that the proposed rule change is consistent with is consistent with Rule 17Ad-22(e)(6)(i) and (v).²⁶

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 Act²⁷ and Rules 17Ad-22(e)(4)(i) and (ii) and (e)(6)(i) and (v) thereunder.²⁸

²⁶ 17 CFR 240.17Ad-22(e)(6)(i) and (v).

²⁷ 15 U.S.C. 78q-1(b)(3)(F).

²⁸ 17 CFR 240.17Ad-22(e)(4)(i) and (ii) and (e)(6)(i) and (v).

IT IS THEREFORE ORDERED pursuant to Section 19(b)(2) of the Act²⁹ that the proposed rule change (SR-ICEEU-2019-006) be, and hereby is, approved.³⁰

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.³¹

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Deputy Secretary

²⁹ 15 U.S.C. 78s(b)(2).

³⁰ 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).

³¹ 17 CFR 200.30-3(a)(12).