

**SECURITIES AND EXCHANGE COMMISSION**

Release No. 34-87722; File No. SR-ICEEU-2019-027

December 12, 2019

Self-Regulatory Organizations; ICE Clear Europe Limited; Notice of Filing of Proposed Rule Change, as Modified by Partial Amendment No. 1, Relating to Amendments to the ICE Clear Europe CDS Procedures

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> notice is hereby given that on December 2, 2019, ICE Clear Europe Limited (“ICE Clear Europe” or the “Clearing House”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change described in Items I, II and III below, which Items have been prepared by ICE Clear Europe. On December 10, 2019, ICE Clear Europe filed Partial Amendment No. 1 to the proposed rule change.<sup>3</sup> The Commission is publishing this notice to solicit comments on the proposed rule change, as modified by Partial Amendment No. 1 (hereafter referred to as the “proposed rule change”), from interested persons.

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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> Partial Amendment No. 1 amended the filing to remove from the filed Exhibit 5 certain dates in brackets and replace them with new dates and remove other language left in brackets; update page numbering in the filed Exhibit 2 so that the page numbering in the filed Exhibit 2 states “of 59” instead of “of 60”; and update a reference to paragraph 8(c) of the CDS Procedures in the original filing so that it instead refers to paragraph 8.1(c) of the CDS Procedures.

**I. Clearing Agency’s Statement of the Terms of Substance of the Proposed Rule Change**

ICE Clear Europe proposes to make certain changes to its CDS Procedures<sup>4</sup> to incorporate amendments to the industry-standard ISDA 2014 Credit Derivatives Definitions (the “2014 Definitions”) that are being adopted in the broader CDS market to address so-called narrowly tailored credit events and related matters.

**II. Clearing Agency’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change**

In its filing with the Commission, ICE Clear Europe 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. ICE Clear Europe has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of such statements.

**(A) Clearing Agency’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change**

(a) **Purpose**

ICE Clear Europe proposes amendments to its CDS Procedures to incorporate changes to the 2014 Definitions that are intended to address so-called “narrowly tailored credit events”. In the wake of certain credit events and potential credit events in the CDS market in recent years, the International Swaps and Derivatives Association, Inc. (“ISDA”), in consultation with market participants, has developed and published the

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<sup>4</sup> Capitalized terms used but not defined herein have the meanings specified in the ICE Clear Europe Rules or CDS Procedures.

2019 Narrowly Tailored Credit Event Supplement to the 2014 ISDA Credit Derivatives Definitions (the “NTCE Supplement”).<sup>5</sup> The NTCE Supplement, if applied to a CDS transaction, effects two principal changes to the 2014 Definitions: (1) a change to the definition of the “Failure to Pay” credit event designed to exclude certain narrowly tailored credit events and (2) a change to the process for determining the Outstanding Principal Balance of an obligation to address certain obligations of a reference entity that were issued at a discount.

As described by ISDA in the attached guidance to the NTCE Supplement, the supplement was published in light of concerns among market participants and regulators about “instances of (CDS) market participants entering into arrangements with corporations that are narrowly tailored to trigger a credit event for CDS contracts while minimizing the impact on the corporation, in order to increase payment to the buyers of CDS protection.”<sup>6</sup> ISDA has expressed concern that “narrowly tailored defaults . . . could negatively impact the efficiency, reliability and fairness of the overall CDS market.” Regulators have also expressed concern with narrowly tailored or manufactured credit events, including a joint statement by the heads of the Commission, the Commodity Futures Trading Commission and the UK Financial Conduct Authority that such strategies “may adversely affect the integrity, confidence and reputation of the credit derivatives markets, as well as markets more generally. These opportunistic strategies

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<sup>5</sup> The NTCE Supplement is published on the ISDA website at <https://www.isda.org/a/KDqME/Final-NTCE-Supplement.pdf>.

<sup>6</sup> NTCE Supplement, Guidance on the interpretation of the definition of “Failure to Pay”.

raise various issues under securities, derivatives, conduct and antifraud laws, as well as policy concerns.”<sup>7</sup>

With respect to the Failure to Pay credit event, the NTCE Supplement adopts a concept of a “Credit Deterioration Requirement.” If applicable, this requirement will provide that a failure of a reference entity to make a payment on an obligation will not constitute a Failure to Pay Credit Event if the failure “does not directly or indirectly either result from, or result in, a deterioration in the creditworthiness or financial condition” of the reference entity. As such, a “narrowly tailored” or “manufactured” failure to pay, which does not reflect or result in a credit deterioration, would not constitute a Credit Event for CDS Contracts that incorporate the NTCE Supplement and apply the Credit Deterioration Requirement. The NTCE Supplement also includes guidance as to factors relevant to the determination of whether credit deterioration has occurred. That determination would, under the 2014 Definitions, in the ordinary course be made by the relevant Credit Derivatives Determinations Committee.

The NTCE Supplement also amends the method of calculating the Outstanding Principal Balance of obligations. The amendments are intended to address a potential scenario where a corporation agrees to issue a bond at a substantial discount to its principal amount, where the bond could be delivered in settlement of a CDS at its full principal amount. Under the 2014 Definitions, the Quantum of the Claim (which is used

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<sup>7</sup> Securities and Exchange Commission, Commodity Futures Trading Commission and UK Financial Conduct Authority, Joint Statement on Opportunistic Strategies in the Credit Derivatives Markets (June 24, 2019); see also Update to June 2019 Joint CFTC-SEC-FCA Statement on Opportunistic Strategies in the Credit Derivatives Market (Sept. 19, 2019).

to determine the Outstanding Principal Balance used in calculating settlement obligations) is determined taking into account any applicable laws insofar as they reduce the size of the claim to reflect the original issue price or accrued value of the obligation. The NTCE Supplement clarifies that the applicable laws to be considered include any bankruptcy or insolvency law or other law affecting creditors' rights to which the relevant obligation is or may become subject. In addition, the NTCE Supplement includes the concept of "Fallback Discounting," which if designated to be applicable, provides a method for discounting the Quantum of the Claim (where it is not otherwise reduced under applicable law or pursuant to its own terms) of an obligation that is issued at less than 95% of its principal amount, based on straight-line interpolation between the issue price and the principal amount.

ICE Clear Europe has been advised that CDS market participants are expected to commence transacting in CDS incorporating the NTCE Supplement (with Credit Deterioration Requirement and Fallback Discounting applicable) on or about January 27, 2020. In addition, ISDA has published, and opened for adherence, an NTCE Protocol pursuant to which parties may, on a multilateral basis, agree to amend outstanding, non-cleared CDS transactions to incorporate the NTCE Supplement. The amendments made by the NTCE Protocol are also expected to have an implementation date of on or about January 27, 2020. Adherence to the protocol will thus make existing transactions fungible with transactions on the new terms. Accordingly, ICE Clear Europe is proposing to amend its CDS Procedures for relevant products to incorporate the NTCE Supplement, both for new and existing cleared transactions. For this purpose, the proposed ICE Clear Europe amendments would apply to all cleared CDS contracts with

corporate (i.e., non-sovereign) reference entities, consistent with the NTCE Protocol and the expected approach for new CDS transactions. ICE Clear Europe proposes to make such changes effective by the industry implementation date.

Specifically, ICE Clear Europe would amend paragraph 1 of the CDS Procedures to include new definitions for “2019 NTCE Protocol”, “2019 NTCE Supplement” and “NTCE Protocol Effective Date”, which will be the date of implementation of the amendment. The NTCE Protocol Effective Date will be January 27, 2020 (or such later date as designated by ICE Clear Europe by Circular). ICE Clear Europe would renumber the remaining provisions of paragraph 1 of the CDS Procedures accordingly.

ICE Clear Europe would further amend relevant subparts of the CDS Procedures to implement the NTCE Supplement for 2014-type CDS Contracts cleared by ICE Clear Europe. In this regard, in paragraph 8.1(c) of the CDS Procedures, a new subparagraph (iii) would be added to provide that for 2014-type CDS Contracts in effect as of the NTCE Protocol Effective Date or cleared one or after that date, the Applicable Credit Derivatives Definitions include the 2019 NTCE Supplement. Certain other amendments would apply to index CDS transactions and certain other amendments would apply to single-name CDS transactions.

For index CDS transactions, for iTraxx Europe transactions, in paragraph 9 of the CDS Procedures, the definitions of iTraxx Terms Supplement and iTraxx Legacy Terms Supplement would be amended to include the new standard terms supplement and confirmations for such transactions, which incorporate the NTCE Supplement (or any electronic equivalent thereto or other applicable document specified by the Clearing House). Pursuant to paragraphs 9.2 and 9.3, the applicable new documentation would

apply to iTraxx Contracts submitted for clearing on or after the NTCE Protocol Effective Date. Conforming changes to other provisions to include references to such definitions would be made. In addition, a new paragraph 9.8 would be added to provide that existing open positions in iTraxx Contracts that are 2014-type CDS Contracts or that include a Component Transaction that is a 2014-type CDS Contract, would be amended, as of the NTCE Protocol Effective Date, to reference the applicable new standard terms supplement and confirmation in lieu of the standard terms supplement and confirmation previously in effect. This will have the effect of converting existing iTraxx Contracts to reference the new standard terms incorporating the NTCE Supplement, such that they will be fungible with new iTraxx Contracts, which will also reference the new standard terms supplement and confirmation.

Substantially similar changes for CDX.NA Contracts would be made in paragraph 10 of the CDS Procedures.

In the case of Single Name Contracts, the CDS Procedures would be amended by adding a new paragraph 11.8, which provides that existing open positions in all Single Name Contracts (other than Single Name Contracts for which the Relevant Transaction Type is "Standard Western European Sovereign") that are 2014-type CDS Contracts would be amended, effective as of the NTCE Protocol Effective Date, to reference the new relevant ISDA physical settlement matrix, to be published as of the NTCE Protocol Effective Date. The amendments will have the effect of converting existing Single Name Contracts to reference the updated physical settlement matrix, such that they will be fungible with new Single Name Contracts, which will also reference that matrix. The amendments would also provide that the amendments would be effective regardless of

whether any transaction record in the Deriv/SERV warehouse is updated to reflect the change. Conforming changes would be made throughout paragraph 11 to reflect this change.

(b) Statutory Basis

ICE Clear Europe believes that the proposed rule changes are consistent with the requirements of Section 17A of the Act<sup>8</sup> and the regulations thereunder applicable to it, including the applicable standards under Rule 17Ad-22.<sup>9</sup> In particular, Section 17A(b)(3)(F) of the Act requires that the rule change be consistent with the prompt and accurate clearance and settlement of securities transactions and derivative agreements, contracts and transactions cleared by ICE Clear Europe, the safeguarding of securities and funds in the custody or control of ICE Clear Europe or for which it is responsible, and the protection of investors and the public interest.<sup>10</sup>

The amendments incorporate changes to the standard terms of CDS Contracts that are being widely adopted by market participants to address potential concerns that have arisen with so-called narrowly tailored credit events. The amendments reflect amendments to the 2014 Definitions, specifically with respect to the Failure to Pay and Outstanding Principal Balance definitions, that have been developed by ISDA, in consultation with market participants in both the cleared and uncleared CDS markets, and are set out in the NTCE Supplement. ICE Clear Europe understands that for the

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<sup>8</sup> 15 U.S.C. 78q-1.

<sup>9</sup> 17 C.F.R. § 240.17Ad-22.

<sup>10</sup> 15 U.S.C. 78q-1(b)(3)(F).

uncleared swap market, these amendments are expected to be widely implemented through the NTCE Protocol. ICE Clear Europe notes that the heads of the Commission, the Commodity Futures Trading Commission and the UK Financial Conduct Authority have stated that they welcome the efforts to implement the amendments set out in the NTCE Supplement and NTCE Protocol.<sup>11</sup> ICE Clear Europe is proposing to adopt amendments to its CDS Procedures to implement these same changes for both new and existing contracts cleared by it. As a result, in ICE Clear Europe’s view, the amendments will enhance the integrity of the credit derivatives markets and the confidence of market participants in those markets, and will therefore facilitate the prompt and accurate clearance and settlement of such contracts at ICE Clear Europe and will further facilitate the protection of investors and the public interest, within the meaning of Section 17A(b)(3)(F) of the Act. ICE Clear Europe does not believe the amendments will materially affect the safeguarding of securities and funds in the custody or control of ICE Clear Europe or for which it is responsible.

The amendments will also satisfy relevant requirements of Rule 17Ad-22,<sup>12</sup> as set forth in the following discussion.

*Legal Framework.* Rule 17Ad-22(e)(1)<sup>13</sup> requires a clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to “provide for a well-founded, transparent and enforceable legal framework for each aspect

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<sup>11</sup> Update to June 2019 Joint CFTC-SEC-FCA Statement on Opportunistic Strategies in the Credit Derivatives Markets (Sept. 19, 2019).

<sup>12</sup> 17 C.F.R. § 240.17Ad-22.

<sup>13</sup> 17 C.F.R. § 240.17Ad-22(e)(1).

of its activities in all relevant jurisdictions.”<sup>14</sup> The amendments to the CDS Procedures are designed to supplement the contractual terms, consistent with industry initiatives, to address and reduce the likelihood of certain situations involving narrowly tailored credit events that have given rise to concerns among market participants and regulators, as described above. As such, ICE Clear Europe believes that the amendments will enhance the legal framework for clearing of CDS Contracts, consistent with the requirements of Rule 17Ad-22(e)(1).<sup>15</sup>

*Risk Management.* Rule 17Ad-22(e)(3)<sup>16</sup> requires a clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to “maintain a sound risk management framework for comprehensively managing legal, credit, liquidity, operational, general business, custody and other risks that arise in or are borne by the” clearing agency.<sup>17</sup> ICE Clear Europe believes the amendments, by implementing the NTCE Supplement for existing and new CDS Contracts, will be consistent with, and eliminate basis risk as compared to, changes being made in the uncleared CDS markets. The changes will also ensure the fungibility of new and existing contracts in light of the NTCE Supplement amendments, which will facilitate ongoing risk management by the clearing house and market participants. As a result, in ICE Clear

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<sup>14</sup> 17 C.F.R. § 240.17Ad-22(e)(1).

<sup>15</sup> 17 C.F.R. § 240.17Ad-22(e)(1).

<sup>16</sup> 17 C.F.R. § 240.17Ad-22(e)(3).

<sup>17</sup> 17 C.F.R. § 240.17Ad-22(e)(3).

Europe's view, the amendments are consistent with the requirements of Rule 17Ad-22(e)(3).<sup>18</sup>

(B) Clearing Agency's Statement on Burden on Competition

ICE Clear Europe 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 reflect an industry-wide initiative designed to apply to all CDS market participants, in both the cleared and uncleared markets. ICE Clear Europe's specific amendments to its CDS Procedures will apply consistently across all Clearing Members, their customers and other market participants. ICE Clear Europe further expects that other market participants will make similar changes to their contracts and terms of trading. As a result, ICE Clear Europe does not expect that the proposed changes will adversely affect access to clearing or the ability of Clearing Members, their customers or other market participants to continue to clear contracts, including CDS Contracts. ICE Clear Europe also does not believe the amendments would materially affect the cost of clearing or otherwise limit market participants' choices for selecting clearing services. Accordingly, ICE Clear Europe does not believe the amendments would impose any burden on competition not necessary or appropriate in furtherance of the purpose of the Act.

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<sup>18</sup> 17 C.F.R. § 240.17Ad-22(e)(3).

(C) Clearing Agency's Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others

ICE Clear Europe has conducted a public consultation on the amendments to its CDS Procedures set forth herein.<sup>19</sup> ICE Clear Europe received two written responses to the consultation pursuant to which certain definitional clarifications and minor typographical corrections were requested. ICE Clear Europe has made certain drafting clarifications to the proposed rules as a result of these requests. Certain comments in these responses related to the standard terms supplements and confirmations referenced in the revised CDS Procedures, and ICE Clear Europe determined that no changes to the proposed rules themselves were appropriate as a result of such comments. One commenter also questioned whether there was a need to explicitly amend Customer-CM Transactions as a result of the proposed rule changes; ICE Clear Europe determined that no such change was necessary to effectuate the proposed rule amendments. ICE Clear Europe will notify the Commission of any further written comments with respect to the proposed rules received by ICE Clear Europe.

**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:

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<sup>19</sup> ICE Clear Europe Circular C19/175 (November 12, 2019), available at [https://www.theice.com/publicdocs/clear\\_europe/circulars/C19175.pdf](https://www.theice.com/publicdocs/clear_europe/circulars/C19175.pdf).

- (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](mailto:rule-comments@sec.gov). Please include File Number SR-ICEEU-2019-027 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-ICEEU-2019-027. 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, N.E., Washington, D.C. 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 Europe and on ICE Clear Europe's website at <https://www.theice.com/clear-europe/regulation>. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-ICEEU-2019-027 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>20</sup>

J. Matthew DeLesDernier  
Assistant Secretary

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<sup>20</sup> 17 CFR 200.30-3(a)(12).