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SECURITIES AND EXCHANGE COMMISSION

(Release No. 34-68563; File No. SR-ICEEU-2012-11)

January 2, 2013

Self-Regulatory Organizations; ICE Clear Europe Limited; Notice of Filing of Proposed Rule Change Relating to Enhanced Margin Methodology

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 28, 2012, ICE Clear Europe Limited (“ICE Clear Europe”) 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 ICE Clear Europe. 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

ICE Clear Europe proposes to implement an enhanced margin methodology (“Decomp Model”) that addresses the risk of both index and single-name credit default swaps (“CDS”) cleared by ICE Clear Europe and permits appropriate portfolio margining between related index and single-name CDS positions.

II. Self-Regulatory Organization’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

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

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 these statements.<sup>3</sup>

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

A fundamental aspect of the Decomp Model is the recognition that index CDS instruments cleared by ICE Clear Europe are essentially a composition of specific single-name CDS. The Decomp Model includes the following enhancements to the ICE Clear Europe margin methodology for index CDS instruments (which are already in place for single-name CDS): replacing standard deviation with mean absolute deviation (MAD) as a measure of credit spread variability, use of an auto regressive process to obtain multi-horizon risk measures, an increased number of spread response scenarios, introduction of liquidity requirements and introduction of enhanced concentration charge computations to reflect net notional amounts in addition to the currently used 5-Year ("5Y") equivalent notional amount. These enhancements and the enhancements referenced below have been reviewed and/or recommended by the ICE Clear Europe risk management personnel, risk and model review working groups and committees, the ICE Clear Europe Risk Committee and an independent third-party risk expert (Finance Concepts). Implementation of these enhancements to the ICE Clear Europe risk methodology will result specifically in a better measurement of the risk associated with clearing index CDS.

As a result of the decomposition of the index CDS, ICE Clear Europe will also be able to (1) incorporate jump-to-default risk as a component of the risk margin associated with index CDS (which is already in place for single-name CDS) and (2) provide appropriate portfolio margin treatment between index CDS and offsetting single-name CDS positions. Incorporating jump-to-default risk as a component of the Decomp Model will result in a better measurement of

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<sup>3</sup> The Commission has modified the text of the summaries prepared by ICE Clear Europe.

the risk associated with clearing index CDS (as is already the case for single-name CDS).

Recognizing the highly correlated relationship between long-short positions in index CDS and the underlying single-name CDS constituents of an index CDS will provide for fundamental and appropriate portfolio margin treatment.

Upon approval of the Decomp Model, ICE Clear Europe would initially make appropriate portfolio margining available with respect to its Clearing Members' proprietary positions. ICE Clear Europe does not currently clear CDS positions of customers of its Clearing Members, but it plans to introduce customer clearing for CDS upon receipt of applicable regulatory approvals.<sup>4</sup> The Commission has granted an exemptive order permitting ICE Clear Europe to commingle customer positions in index CDS and single-name CDS carried through FCM/BD Clearing Members in a single account;<sup>5</sup> in addition, ICE Clear Europe has petitioned the Commodity Futures Trading Commission to permit such commingling.<sup>6</sup> Following the commencement of customer clearing for CDS, and receipt of all necessary regulatory approvals, ICE Clear Europe would make appropriate portfolio margining available to commingled customer positions in index and single-name CDS using the Decomp Model. Accordingly, the Decomp Model is an important component of ICE Clear Europe's planned customer clearing offering.

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<sup>4</sup> ICE Clear Europe has filed separately with the Commission proposed rule changes relating to customer clearing for CDS. See Securities Exchange Act Release No. 34-68152 (November 5, 2012), 77 FR 67427 (November 9, 2012).

<sup>5</sup> See Securities Exchange Act Release No. 34-68433 (December 14, 2012), 77 FR 75211 (December 19, 2012).

<sup>6</sup> See letter from Paul Swann, President & Chief Operating Officer, ICE Clear Europe to Mr. David Stawick, Secretary, Commodity Futures Trading Commission, dated May 31, 2012.

ICE Clear Europe does not believe that the expected phased implementation of the portfolio margining element of the proposed Decomp Model (commencing with proprietary positions) raises an issue of unfair discrimination. Importantly, the portfolio margining aspect of the Decomp Model does not unfairly discriminate with respect to similarly situated participants because it is available to any participant for whom ICE Clear Europe is currently able to provide portfolio margin treatment. ICE Clear Europe does not currently offer customer clearing in CDS. Once it does so, and upon receipt of all necessary regulatory approvals, ICE Clear Europe will offer portfolio margining with respect to customer positions. The proposed rule amendments are thus not designed to permit unfair discrimination among participants in the use of ICE Clear Europe's clearing services.

In addition, as part of the implementation of the proposed Decomp Model, ICE Clear Europe proposes to (1) reduce the current level of risk mutualization among ICE Clear Europe's CDS Clearing Members through the default resources held in the mutualized CDS Guaranty Fund and significantly increase the level of resources held as initial margin for CDS Contracts ("Guaranty Fund/IM Modification"), (2) modify the initial margin risk model approach in a manner that will make it easier for market participants to measure their risks, by removing the conditional recovery rate stress scenarios and adding a new recovery rate sensitivity component ("IM Recovery Rate Modification"), (3) introduce the 5Y equivalent notional amount ("5Y ENA") per single-name/index with the worst of concentration charge based on 5Y ENA or net notional amount ("NNA") being applied ("IM Concentration Charge Modification"), (4) add a new basis risk component from single-name CDS positions that are offset by index-derived single-name CDS positions ("IM Basis Risk Modification") and (5) combine a single guaranty fund calculation for index CDS and single-name CDS positions ("Guaranty Fund Modification").

Currently, ICE Clear Europe maintains a high percentage of its default resources for CDS Contracts in the CDS Guaranty Fund, as compared to initial margin for CDS Contracts. This reflects the fact that the current CDS Guaranty Fund model is designed to cover the uncollateralized losses that would result from the three single names that would cause the greatest losses when entering a state of default. The Guaranty Fund/IM Modification incorporates into the initial margin risk model the single name that causes the greatest loss when entering a state of default (i.e., the single name that results in the greatest amount of loss when stress-tested to undergo a credit event). This change effectively collateralizes the loss that would occur from this single name upon default. Consequently, the amount of uncollateralized loss that would result from the three single names causing the greatest losses when entering a state of default is reduced, thereby reducing the amount of required contributions to the CDS Guaranty Fund.

It is important to note that the decrease in the CDS Guaranty Fund and the increase in initial margin requirements are not equivalent in terms of magnitudes. Instead, based on current portfolios, it is expected that for every \$1 decrease in the CDS Guaranty Fund requirement there will be a corresponding increase of approximately \$5 in initial margin requirements.

The IM Recovery Rate Modification modifies the initial margin risk model by removing the conditional recovery rate stress scenarios and adding a new recovery rate sensitivity component that is computed by considering changes in the recovery rate assumptions and their impact on the net asset value of the CDS portfolio. This modification will make it easier for market participants to replicate their initial margin requirements.

The IM Concentration Charge Modification defines concentration charge thresholds in terms of NNA as well as 5Y ENA and takes the more conservative concentration requirement

based on either notional amount. This modification captures the risk of large directional CDS positions that may not be captured by the calculation based on NNA. For example, a set of large NNA positions, whose maturity date is close to the current date, may not be subject to concentration charges based on 5Y ENA if the estimated 5Y ENA is below the established threshold. The alternative NNA-based concentration charge computations may yield significant additional initial margin requirements as the NNA exceeds the established threshold.

As index-derived single-name positions and outright single-name positions are offset, an additional basis risk requirement is introduced to account for the fact that the index instruments are more actively traded than single-name instruments and thus are the preferred instruments to express changing views about the credit market as a whole, or even about specific single-name components of the indices. The IM Basis Risk Modification captures the risk associated with differences between outright single-name CDS positions and index-derived single-name CDS positions. In other words, a “perfectly hedged” portfolio consisting of an index CDS position and opposite index replicating single-name CDS positions will still attract an initial margin requirement due to the basis risk that exists.

Currently, ICE Clear Europe estimates separate guaranty fund sizes for index CDS positions and single-name positions. The Guaranty Fund Modification takes into account the portfolio benefits between index and single-name positions, and incorporates the worst 2-member uncollateralized losses coming from the jump-to-default, spread response, basis and interest rate stress scenario considerations.

Section 17A(b)(3)(F) of the Act<sup>7</sup> requires, among other things, that the rules of a clearing agency be designed to promote the prompt and accurate clearance and settlement of securities

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<sup>7</sup> 15 U.S.C. 78q-1(b)(3)(F).

transactions and, to the extent applicable, derivative agreements, contracts, and transactions, and 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. ICE Clear Europe believes that the changes will facilitate the prompt and accurate settlement and risk management of security-based swaps and contribute to the safeguarding of securities and funds associated with security-based swap transactions. As discussed above, ICE Clear Europe does not believe that the portfolio margining-related proposed changes raise an issue of unfair discrimination in the use of ICE Clear Europe's clearing services by similarly situated participants.

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

ICE Clear Europe does not believe the proposed changes to its margin methodology would have any impact, or impose any burden, on competition.

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

ICE Clear Europe will notify the Commission of any written comments received by ICE Clear Europe. As noted above, ICE Clear Europe has consulted extensively with CDS Clearing Members and others in developing the Decomp Model.

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](mailto:rule-comments@sec.gov). Please include File Number SR-ICEEU-2012-11 on the subject line.

##### Paper Comments:

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

All submissions should refer to File Number SR-ICEEU-2012-11. 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 Europe and on ICE Clear Europe's website at

[https://www.theice.com/publicdocs/regulatory\\_filings/ICEU\\_SEC\\_122812.pdf](https://www.theice.com/publicdocs/regulatory_filings/ICEU_SEC_122812.pdf).

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-ICEEU-2012-11 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>8</sup>

Kevin M. O'Neill  
Deputy Secretary

am; Publication Date: 01/08/2013]

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<sup>8</sup> 17 CFR 200.30-3(a)(12).