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SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-75426; File No. SR-ICEEU-2015-010)

Self-Regulatory Organizations; ICE Clear Europe Limited; Notice of Filing of Proposed Rule Change Relating to Credit Default Swap Risk Policies

July 10, 2015

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 June 25, 2015, ICE Clear Europe Limited (“ICE Clear Europe” or the “Clearing House”) 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 primarily prepared by ICE Clear Europe. The Commission is publishing this notice to solicit comments on the proposed changes to the rules from interested persons.

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

ICE Clear Europe proposes to amend certain of its credit default swap (“CDS”) risk policies (the “Risk Policy Amendments”) in order to enhance its current risk model.

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. The text of these statements may be examined at the places specified in Item IV below. ICE Clear Europe

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

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

has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of such statements.

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

1. Purpose

The principal purpose of the proposed rule change is to amend certain ICE Clear Europe risk policies relating to the CDS product category to incorporate enhancements to the existing CDS risk model. The relevant policies being modified are the CDS Risk Policy ("CDS Risk Policy") and the CDS Risk Model Description ("Risk Model Description"). ICE Clear Europe does not propose to make any changes to its Clearing Rules or Procedures in connection with these amendments.

The proposed rule change would, among other matters, (i) modify the credit spread response component of the risk model to devolatilize returns, (ii) enhance the portfolio spread response component of the risk model to limit procyclicality, (iii) establish a new framework for recovery rate sensitivity requirement ("RRSR") parameters, (iv) modify the CDS Guaranty Fund allocation methodology, (v) modify index liquidity and concentration charges and (vi) revise procedures for intraday margin calls. The Risk Policy Amendments also include certain other clarifications and conforming changes.

The following is a summary of the principal changes in the Risk Policy Amendments:

Devolatilization of Credit Spread Response. Under the revised Risk Model Description, the credit spread response component of the margin model would be revised to provide that the tail estimation of the relevant fitted returns distribution is based on

devolatilized returns. The use of devolatilized returns in this manner facilitates the comparison of returns for periods with different volatilities.

*Procyclicality of Portfolio Spread Response.* In order to limit procyclicality of the spread response component of the model, ICE Clear Europe proposes to modify the CDS Risk Policy and Risk Model Description to use an additional portfolio analysis that features price changes observed during and immediately after the Lehman Brothers default. The analysis considers price scenarios derived from the greatest price decrease and increase during and immediately after the Lehman Brothers default. These scenarios are designed to capture the default of a major participant in the credit market and the market response to the event. The introduced scenarios are defined in price terms to maintain the stress severity during periods of low credit spread levels (high price) when the spread response requirements, computed under the current framework, are expected to be lower. Furthermore, the Lehman default price scenarios are also incorporated into the calculation of CDS Guaranty Fund requirements.<sup>3</sup>

*Recovery Rate Sensitivity Requirements.*

ICE Clear Europe proposes to revise the Risk Model Description to incorporate a more sensitive parameter estimation approach for the RRSR computation. The RRSR factor is designed to capture the risk of fluctuations in market expected recovery rates under CDS transactions. Under the current model, the RRSR is determined using fixed

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<sup>3</sup> This enhancement also addresses a regulatory requirement in Article 30 of the Regulatory Technical Standards implementing the European Market Infrastructure Regulations (“EMIR”). Commission Delegated Regulation (EU) No. 153/2013 of 19 December 2012 Supplementing Regulation (EU) No. 648/2012 of the European Parliament and of the Council with regard to Regulatory Technical Standards on Requirements for Central Counterparties (the “Regulatory Technical Standards”).

minimum and maximum recovery rate stress scenarios based on sector levels. In calculating the RRSR, all instruments belonging to a risk factor (“RF”) or risk sub-factor (“RSF”) are subjected to recovery rate stress scenarios to obtain resulting profit/loss responses, and the worst scenario response is chosen for the estimation of the RRSR. (In addition, these same recovery rate stress scenarios are used in determination of jump-to-default requirements.)

ICE Clear Europe proposes separating the recovery rate stress levels for these two computations in order to introduce more dynamic and appropriate estimations of the recovery rate stress levels for RRSR purposes. Under the revised framework, the recovery rate levels for RRSR purposes will be determined using a 5-day, 99% confidence interval expected shortfall risk measure assuming a distribution of recovery rate fluctuations. The proposal will also eliminate index RRSR, as index recovery rates are assumed under relevant market convention and are thus not subject to market uncertainty. The dynamic feature of the revised stress level estimations is achieved by analyzing historical time series of recovery rates in order to calibrate a statistical model with a time varying volatility. In ICE Clear Europe’s view, the proposed enhancements provide a robust and quantitative driven approach for establishing the recovery rate stress scenarios.

Modifications to Guaranty Fund Methodology. ICE Clear Europe proposes certain clarifications and enhancements to its CDS Guaranty Fund methodology. The Risk Model Description has been revised to clarify that the CDS Guaranty Fund size is calculated to cover losses associated with the default of the two Clearing Members and their affiliates that create the greatest cumulative uncollateralized loss under extreme but

plausible scenarios. Certain other clarifications have been made in the calculation of the various components of the overall CDs Guaranty Fund requirement.

ICE Clear Europe also proposes to modify the procedure for allocating CDS Guaranty Fund requirements among the CDS Clearing Members. Under the existing model, CDS Guaranty Fund allocations reflect a risk “silo” approach, in which a Clearing Member’s contribution reflects its uncollateralized exposure for each CDS Guaranty Fund component or “silo”. Under the current approach, allocations can significantly fluctuate in response to position changes in the portfolios of the Clearing Members that drive the CDS Guaranty Fund size, and in response to the distribution of the total CDS Guaranty Fund size across all “silos”. The Clearing House proposes modifying the methodology, so that the allocations are based on the Clearing Members’ total unconditional uncollateralized losses in the CDS product category.<sup>4</sup> Under the proposed approach, the allocations are independent of the distribution of the uncollateralized losses across the “silos”. In ICE Clear Europe’s view, the new allocation methodology reflects an improved and more stable approach which allows for easier attributions of contributions to individual CDS Clearing Member or client portfolios.

The CDS Risk Policy’s discussion of the ICE Clear Europe’s initial CDS Guaranty Fund contribution has been revised to be consistent with the requirements of the Finance Procedures.

*Index Liquidity and Concentration Charges.*

ICE Clear Europe proposes to modify the liquidity charge calculation in the margin model as it applies to index CDS positions. (The existing liquidity charge calculation for

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<sup>4</sup> The existing specific wrong way risk component of the CDS Guaranty Fund calculation is maintained.

single-name CDS will remain unchanged.) The revised approach will address calculation of liquidity charges where index CDS is traded under either price or spread terms, and will calculate a separate liquidity charge for positions in each series of the relevant index. The revised approach also limits the reduction in liquidity charge for offsetting positions across different series of the same index family, by applying the greater of the liquidity charge applicable to the long and short positions in the relevant portfolio in the same index family. Under the revised methodology, the reduction in liquidity charge is greatest across positions in the “on-the-run” (current) index and first (most recent) “off-the-run” indices, with a higher reduction during the period immediately following the index roll (when the two indices are treated as effectively the same index) and a lower reduction over time as the liquidity of contracts in the two series diverge.

Similarly, ICE Clear Europe proposes to modify the concentration charge calculation for index CDS positions. (Again, the existing approach for single-name CDS will not change.) The revised framework provides for calculation of series-specific concentration charges, based on the direction of the 5-year equivalent notional amount or the net notional amount of positions in the particular series and a series threshold limit (above which the concentration charge is imposed). Series threshold limits are expected to be higher for the on-the-run and the first off-the-run index series, and are determined based on a formula comparing the open interest in the series to the on-the-run open interest.

#### *Intraday Margin Calls.*

Certain amendments are proposed to the intra-day risk monitoring and special margin call processes. Intra-day margin calls will be made based on an “Intraday Risk Limit.” The Intraday Risk Limit is set at the Clearing Member level and is calculated based on 40% of the total initial margin requirements (across all account classes), with a

minimum amount of EUR 15 million and a maximum of EUR 100 million. Intra-day margin calls will be made on the following basis: (i) where there has been a 50% erosion of the Intraday Risk Limit, the Risk Department will investigate what is driving the shortfall and monitor the CDS Clearing Member, (ii) where the erosion of the Intraday Risk Limit exceeds 50%, the Risk Department will inform the CDS Clearing Member that its initial margin may cease to be sufficient and that it may be subject to an intraday margin call, and (iii) where there has been a 100% erosion of the Intraday Risk Limit, the Risk Department will issue an intraday margin call to the CDS Clearing Member (and will also contact it by telephone and/or email) for a sum sufficient to reduce the level of Intraday Risk Limit erosion back to 0%. The member intraday shortfall is the sum of intraday shortfalls at account level (i.e. house and client accounts), and the account level shortfall represents the unrealized profit and loss from the aggregate change in the Mark-to-Market Margin and Initial Margin.

Governance. The CDS Risk Policy has been revised to address in further detail management and governance oversight in a new Management and Governance Oversight section. The new section provides that the CDS Director of Risk is responsible for ensuring that the CDS Risk Policy remains up-to-date and is reviewed in accordance with certain guidelines. The Risk Working Group (“RWG”) and Trading Advisory Committee (“TAC”) will provide on-going consultation and support with respect to the CDS Risk Policy. The composition of the RWG and the TAC include both ICE Clear Europe Management and Clearing Member representatives, mainly from risk, trading and compliance areas.

Changes to the CDS Risk Policy are subject to initial approval by the Director of Risk and may be determined in consultation with the RWG and/or the TAC. Any

changes that affect the risk profile of ICE Clear Europe are subject to Board approval on the advice and support of the CDS Risk Committee and the Board Risk Committee. In addition, the CDS Risk Policy is subject to at least an annual routine approval by the Board, after consultation with the CDS Risk Committee and the Board Risk Committee. CDS risk model performance testing is subject to review by the Director of Risk and reported to the CDS Risk Committee and the Board Risk Committee.

*Additional Changes.* The Risk Policy Amendments contain certain other clarifications and enhancements. Certain clarifications are made in the CDS Risk Policy with respect to wrong way risk requirements. The policy has also been revised to clarify that the currency specific initial margin requirements must cover at least the specific and general wrong way risk components of the initial margin requirement for the relevant currency. The CDS Risk Policy has also been revised to incorporate (without change) from the Clearing House's existing CDS clearing membership policy the capital-to-margin ratio limit (which requires that certain remedial actions be taken if the margin requirement for a Clearing Member's CDS positions would exceed three times the Clearing Member's capital as set forth on its balance sheet). The description of the Clearing House's Monte Carlo model has been revised to clarify that model parameters used are the same as those used in the credit spread model. Various other defined terms and certain obsolete references have been updated throughout the CDS Risk Policy and Risk Model Description.

## 2. Statutory Basis

ICE Clear Europe believes that the proposed rule change is consistent with the requirements of section 17A of the Act<sup>5</sup> and the regulations thereunder applicable to it, including the standards under Rule 17Ad-22.<sup>6</sup> 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 transactions and, to the extent applicable, derivative agreements, contracts, and transactions, the safeguarding of securities and funds in the custody or control of the clearing agency, and the protection of investors and the public interest. The proposed rule change is designed to enhance relevant risk policies, impose more conservative initial margin requirements and in general tailor CDS margin and guaranty fund requirements more closely to the specific risks presented by cleared CDS Contracts. As a result, ICE Clear Europe believes that the proposed rule change will enhance the financial resources available to the Clearing House and enhance the stability of the clearing system, by reducing the risk to market participants of a default by a CDS Clearing Member or customer. The amendments thereby facilitate the Clearing House's ability to promptly and accurately clear and settle CDS contracts, within the meaning of section 17(A)(b)(3)(F).<sup>8</sup>

In addition, the Risk Policy Amendments are consistent with the relevant requirements of Rule 17Ad-22.<sup>9</sup> In particular, the amendments to the CDS Risk Policy

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<sup>5</sup> 15 U.S.C. 78q-1.

<sup>6</sup> 17 CFR 240.17Ad-22.

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

<sup>8</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>9</sup> 17 CFR 240.17Ad-22.

and Risk Model Description will enhance the financial resources available to the clearing house by imposing more appropriate initial margin requirements for CDS, and are therefore reasonably designed to meet the margin and financial resources requirements of Rule 17Ad-22(b)(2-3).<sup>10</sup> Additionally, the amendments to the CDS Guaranty Fund methodology further ensure that the Clearing House maintains sufficient financial resources for CDS clearing, consistent with the requirements of Rule 17Ad-22(b)(3).<sup>11</sup> The changes also enhance and clarify the Clearing House's governance process concerning review and modification of the CDS risk policies, consistent with the requirements of Rule 17Ad-22(d)(8).<sup>12</sup> For the reasons noted above, ICE Clear Europe believes that the proposed Risk Policy Amendments are consistent with the requirements of Section 17A of the Act and regulations thereunder applicable to it.

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

ICE Clear Europe does not believe the Risk Policy Amendments would have any impact, or impose any burden, on competition not necessary or appropriate in furtherance of the purposes of the Act. The Risk Policy Amendments will apply to all CDS Clearing Members, and the changes to the margin model applicable to customer business will apply to all other market participants. ICE Clear Europe does not believe that the adoption of the policy amendments will adversely affect competition among Clearing Members, or the ability of market participants to clear contracts generally. The Clearing House also does not believe that the amendments will reduce access to clearing CDS

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<sup>10</sup> 17 CFR 240.17Ad-22(b)(2-3).

<sup>11</sup> 17 CFR 240.17Ad-22(b)(3).

<sup>12</sup> 17 CFR 240.17Ad-22(d)(8).

contracts generally or limit market participants' choices for clearing CDS. The Risk Policy Amendments may result in higher initial margin or guaranty fund requirements for certain positions or portfolios of CDS, which may increase the costs for some Clearing Member and other market participants of trading or carrying those positions or portfolios. However, ICE Clear Europe believes that the amendments appropriately tailor CDS margin and guaranty fund requirements to the risks presented by particular CDS positions, and that the amendments will therefore enhance the Clearing House's financial resources and risk management. As a result, in ICE Clear Europe's view, any incremental increase in cost resulting from such higher margin or guaranty fund requirements is warranted in light of the risks posed to the Clearing House. ICE Clear Europe therefore believes that any impact on competition from the amendments is appropriate in furtherance of the purposes 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 rule changes have not been solicited or received. ICE Clear Europe will notify the Commission of any written comments 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:

(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-2015-010 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-2015-010. 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/clear-europe/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-ICEEU-2015-010 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>13</sup>

Jill M. Peterson,  
Assistant Secretary.

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<sup>13</sup> 17 CFR 200.30-3(a)(12).