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SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-77982; File No. SR-ICC-2016-005)

June 2, 2016

Self-Regulatory Organizations; ICE Clear Credit LLC; Notice of Filing of Amendment No. 1 and Order Approving Proposed Rule Change, as modified by Amendment No. 1 Thereto, to Update and Formalize the ICC Stress Testing Framework

I. Introduction

On March 31, 2016, ICE Clear Credit LLC (“ICC” or “ICE Clear Credit”) filed with the Securities and Exchange Commission (“Commission”), 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> a proposed rule change to update and formalize ICC’s stress testing framework. On April 20, 2016 ICC filed Amendment No. 1 to the proposal.<sup>3</sup> The proposed rule change was published for comment in the Federal Register on April 21, 2016.<sup>4</sup> The Commission did not receive comments on the proposed rule change. For the reasons discussed below, the Commission is approving the proposed rule change, as modified by Amendment No. 1.

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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> ICE Clear Credit filed Amendment No. 1 to further revise the Stress Testing Framework to incorporate language regarding the treatment of unrated reference entities for the purposes of applying the stress scenarios. Under Amendment No. 1, ICC has clarified that unrated reference entities are treated as non-investment grade entities with respect to the application of stress scenarios. Amendment No. 1 is not subject to comment because it is a technical, clarifying amendment that does not alter the substance of the proposed rule change or raise any novel regulatory issues.

<sup>4</sup> Securities Exchange Act Release No. 34-77633 (April 15, 2016), 81 FR 23531 (April 21, 2016) (SR-ICC-2016-005).

## II. Description of the Proposed Rule Change

The principal purpose of the proposed rule change is to update and formalize ICC's Stress Testing Framework, which sets forth the stress testing practices instituted by ICC. The framework, according to ICC, is designed to: articulate the types of stress tests executed and the main purpose of each type of test; describe how stress tests are conducted; define the actual test scenarios currently executed; outline the range of remedial actions available (which, depending on the results, may include enhancements to the risk methodology or certain Clearing Participant ("CP") specific action); and explain how stress test results are used in the governance process.

ICC states that the stress testing framework helps ICC identify potential weaknesses in the risk management methodology currently used and, as a result, allows ICC to identify potential model enhancements to the Initial Margin and Guaranty Fund models, as well as identify the need to exercise short term remedies based upon specific CP positions and risk of exposure prior to introduction of model enhancements.

ICC represents that during the execution of stress testing, the ICC Risk Department ("Risk Department") applies the standard set of pre-defined Stress Test Scenarios against actual portfolios, sample portfolios derived from currently cleared positions, and expected future portfolios, as appropriate, to generate hypothetical profits or losses. According to ICC, the Risk Department compares the hypothetical losses to the available funds from the Initial Margin requirements and Guaranty Fund contribution related to the selected portfolios. A scenario deficiency is identified in the event that the hypothetical loss exceeds the protection provided by the available collateral assets and

mutualization funds. ICC states that, depending on the plausibility of the stress scenarios and the frequency and severity of any resulting deficiencies, the Risk Department may recommend enhancements to the risk methodology.

ICC represents that it utilizes certain predefined scenarios for its stress testing, which fall into three standard categories: (i) historically observed extreme but plausible market scenarios; (ii) historically observed and hypothetically constructed (forward looking) extreme but plausible market scenarios with a baseline credit event; and (iii) extreme model response tests (collectively, “Stress Test Scenarios”). ICC states that discordant scenarios (i.e., scenarios under which selected risk factors move in opposite directions; commonly the behavior deviates from historically observed behavior) are applied to certain instruments to account for discordant price moves.

ICC asserts that it applies the Stress Test Scenarios to a variety of portfolios. Specifically, ICC applies the Stress Test Scenarios to all currently cleared portfolios. ICC states that its Risk Department may also apply the Stress Test Scenarios to sample portfolios obtained from currently cleared portfolios and may also apply the Stress Test Scenarios to staff-constructed, expected future portfolios, as ICC’s Risk Department deems appropriate, to mimic expected future portfolios upon the launch of new services. In this case, ICC states that the stress test analysis is presented to and reviewed by ICC’s Risk Committee prior to the launch of the new clearing services. ICC represents that it may design specific portfolio sets to test the validity of certain model/system assumptions. According to ICC, the stress test results from such expected future portfolio executions are reviewed and analyzed internally, and may be used to support future model initiatives.

ICC states that it also designs stress test analysis directed toward the identification of wrong-way risk in cleared portfolios. For every cleared portfolio, ICC asserts that all positions in index risk factors and single name risk factors that exhibit high degree of association with the considered CP are used to create a sub-portfolio which will be subjected to additional stress test analysis. The constructed sub-portfolio is subjected to the same Stress Test Scenarios utilized by ICC.

The framework also describes ICC's reverse stress testing (Guaranty Fund Adequacy Analysis) practices. According to ICC, the purpose of the adequacy analysis is to provide estimates for the level of protection achieved by the clearinghouse via its Initial Margin and Guaranty Fund models. In performing its analysis, ICC represents that it considers a combination of adverse price realizations and idiosyncratic credit events associated with reference obligations on which the stress tested CP sold protection. ICC's Stress Testing Framework also describes the correlation sensitivity analysis performed by ICC, based on Monte Carlo simulations, as well as the additional recovery rate sensitivity analysis.

ICC's framework also details how stress testing is utilized in ICC's governance process. ICC states that it maintains a framework to ensure that ICC's Risk Committee and Board are provided with transparency into the Risk Department's stress test results and contemplated methodology changes. According to ICC, stress testing results are reviewed, at a minimum, by ICC's Risk Department weekly. Additionally, ICC states that stress testing results are provided to ICC's Risk Committee weekly and a report of such results is presented to the Risk Committee on a monthly basis. Ad hoc reviews of the stress testing results may be undertaken at the discretion of ICC's Chief Risk Officer.

In the event of any deficiencies noted upon stress testing, ICC represents that its Risk Department must report such deficiencies to ICC senior management and the Risk Committee, and either (a) provide analysis that the results do not highlight a significant weakness in the stress testing or risk methodology; or (b) recommend enhancements to the stress testing or risk methodology. ICC states that ICC senior management and the Risk Committee will review and recommend any stress testing or risk methodology enhancements to the ICC Board, which is responsible for approval. ICC states that the Risk Department may also choose to add new scenarios and portfolios in response to deficiencies noted upon stress testing; in this case, the Risk Department will discuss with the Risk Committee, which will recommend to the Board, which is responsible for approval.

ICC asserts that the Risk Department maintains a standard set of Stress Scenarios and portfolios (namely actual portfolios, sample portfolios derived from currently cleared portfolios, and expected future portfolios) that are executed on a regular basis. In the event that a scenario or portfolio in the standard set is no longer applicable, or has been superseded by new scenarios or portfolios, ICC claims that the Risk Department may wish to retire or modify the outdated scenario or portfolio, in which case, the Risk Department will, with ICC senior management: conduct analysis to support a recommendation; discuss the analysis and obtain a recommendation from the Risk Committee; and present the final analysis to the Board for approval. ICC states that, in the interest of prudent risk management, the Risk Department may wish to add scenarios and/or portfolios to the standard set and that Risk Committee or Board approval is not

required unless such scenarios and/or portfolios are added in response to stress testing deficiencies, as described above.

Previous versions of ICC's framework included the Risk Working Group in the governance structure, as ICC consulted with the Risk Working Group as it worked to develop its initial stress testing approach and appropriate scenarios. ICC states that, as it now has a fully developed approach, stress testing remains focused on data analysis and reporting results, which ICC claims are addressed at the Risk Committee and Board level. Thus, to reflect current governance practices, references to the Risk Working Group have been removed from its framework.

### III. Discussion and Commission Findings

Section 19(b)(2)(C) of the Act<sup>5</sup> directs the Commission to approve a proposed rule change of a self-regulatory organization if the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to such self-regulatory organization. Section 17A(b)(3)(F) of the Act<sup>6</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, 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 and, in general, to protect investors and the public interest. In addition, Rule 17Ad-22(b)(3),<sup>7</sup> requires registered clearing agencies to

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<sup>5</sup> 15 U.S.C. 78s(b)(2)(C).

<sup>6</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>7</sup> 17 CFR 240.17Ad-22(b)(3).

maintain, at a minimum, sufficient financial resources to withstand a default by the participant family to which it has the largest exposure in extreme but plausible market conditions, and for registered clearing agencies acting as a central counterparty for security-based swaps, to maintain additional financial resources sufficient 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.

The Commission finds that the proposed rule change is consistent with the requirements of Section 17A of the Act<sup>8</sup> and the rules and regulations thereunder applicable to ICC.

ICC's Stress Testing Framework establishes ICC's stress testing practices. These stress testing practices are designed, among other things, to ensure the adequacy of ICC's financial resources under applicable legal requirements, and set forth the methodology by which ICC evaluates potential portfolio profits and losses, compared to the Initial Margin and Guaranty Fund funds maintained, in order to identify any potential weakness in ICC's risk methodology. Such financial resources will facilitate ICC's continued operations in the event of a participant default. As such, the Commission believes that the proposed rule changes are designed to promote the prompt and accurate clearance and settlement of securities transactions, derivatives agreements, contracts, and transactions within the meaning of Section 17A(b)(3)(F)<sup>9</sup> of the Act.

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

<sup>9</sup> Id.

The Commission also believes that the proposed changes will satisfy the applicable requirements of Rule 17Ad-22.<sup>10</sup> In particular, the Stress Testing Framework contains stress testing practices designed to ensure that ICE Clear Credit maintains sufficient financial resources to withstand a default by the participant family to which it has the largest exposure in extreme but plausible market conditions, and that as a registered clearing agency acting as a central counterparty for security-based swaps, ICC maintains additional financial resources sufficient 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, consistent with the requirements of Rule 17Ad-22(b)(3).<sup>11</sup>

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<sup>10</sup> 17 CFR 240.17Ad-22.

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

#### IV. Conclusion

On the basis of the foregoing, the Commission finds that the proposal is consistent with the requirements of the Act and in particular with the requirements of Section 17A of the Act<sup>12</sup> and the rules and regulations thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>13</sup> that the proposed rule change (File No. SR-ICC-2016-005) as modified by Amendment No. 1, be, and hereby is, approved.<sup>14</sup>

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>15</sup>

Brent J. Fields  
Secretary

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<sup>12</sup> 15 U.S.C. 78q-1.

<sup>13</sup> 15 U.S.C. 78s(b)(2).

<sup>14</sup> 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).

<sup>15</sup> 17 CFR 200.30-3(a)(12).

[FR Doc. 2016-13477 Filed: 6/7/2016 8:45 am; Publication Date: 6/8/2016]