



8011-01p
SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-71574; File No. SR-ICEEU-2014-04)

February 19, 2014

Self-Regulatory Organizations; ICE Clear Europe Limited; Notice of Filing of Proposed Rule Change to Clear New Sovereign Contracts

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder² notice is hereby given that on February 11, 2014, 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

The principal purpose of the change is to provide for the clearance of new CDS contracts that are Western European Sovereign CDS contracts referencing the Republic of Ireland, Italian Republic, Portuguese Republic, and Kingdom of Spain (the “New Sovereign Contracts”).

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 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.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

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

1. Purpose

The purpose of the additional CDS products is to allow ICE Clear Europe Clearing Members the ability to clear additional European CDS products through ICE Clear Europe's platform.

ICE Clear Europe has identified Western European Sovereign CDS Contracts as a product that has become increasingly important for market participants to manage risk and express views with respect to the European sovereign credit markets. ICE Clear Europe believes clearance of the New Sovereign Contracts will benefit the markets for credit default swaps on Western European sovereigns by offering to market participants the benefits of clearing, including reduction in counterparty risk and safeguarding of margin assets pursuant to clearing house rules. The terms of the New Sovereign Contracts will be governed by Paragraph 12 of the CDS Procedures. Clearing of the New Sovereign Contracts will not require any changes to ICE Clear Europe's existing Clearing Rules and CDS Procedures (although ICE Clear Europe has updated its risk management framework (including relevant policies) and margin model as discussed herein).

ICE Clear Europe's CDS risk management framework, including the margin methodology (the "CDS Model"),³ has been enhanced to include several features designed to address particular risks of the New Sovereign Contracts. To address so-called general wrong way risk ("General Wrong Way Risk") involving correlation between the risk of default of an underlying sovereign and the risk of default of a clearing member that has written credit

³ ICE Clear Europe has performed a variety of empirical analyses related to clearing of the New Sovereign Contracts under its margin methodology, including back tests and stress tests.

protection through a New Sovereign Contract on such sovereign, additional jump-to-default requirements for initial margin are established for portfolios that present such risk.

ICE Clear Europe proposes to adopt a combination of qualitative and quantitative approaches to capture General Wrong Way Risk. Under the enhanced CDS Model, an additional contribution to initial margin will be required when the seller of protection exhibits a high degree of association with an underlying Western European Sovereign reference entity by virtue of domicile (qualitative approach) or high spread return correlation (quantitative approach). To address General Wrong Way Risk arising from clearing member domicile, ICE Clear Europe will require full collateralization of the jump-to-default loss for a protection seller under a contract referencing the sovereign where the protection seller is domiciled.

Under the quantitative approach, which applies where the protection seller is not domiciled in the jurisdiction of the underlying sovereign, two types of thresholds are introduced: a loss threshold and a correlation threshold. Additional General Wrong Way Risk collateralization will be collected if both thresholds are exceeded. If the spread return correlation between the member and the sovereign is above the correlation threshold and the sovereign CDS jump-to-default loss is above the loss threshold, General Wrong Way Risk collateralization is assessed as a function of the spread return correlation and amount by which the loss threshold is exceeded. The charge becomes more conservative as the spread return correlation increases. The application of additional initial margin requirements under the quantitative approach is not subject to discretion, although the thresholds are subject to review by the CDS Risk Committee as part of its periodic review of ICE Clear Europe's margin methodology.

Other forms of wrong way risk arising from currency risk are also addressed. To mitigate the currency risk between a sovereign reference entity and a New Sovereign Contract involving

that entity, and to facilitate greater market liquidity, the New Sovereign Contracts (and related margin and guaranty fund requirements) are denominated in U.S. dollars, rather than Euro. In addition, the rules contain prohibitions on self-referencing trades (i.e., trades where the clearing member is an affiliate of the underlying sovereign reference entity). Such trades may not be submitted for clearing, and if a clearing member subsequently becomes affiliated with the underlying reference entity, the rules applicable to New Sovereign Contracts provide for the termination of relevant positions.

The ICE Clear Europe CDS Risk Policy, the CDS Risk Model Description methodology document and CDS Wrong Way Risk Policy have been updated to account for these additional features of the risk model for the New Sovereign Contracts.

2. Statutory Basis

ICE Clear Europe believes that clearing of the proposed New Sovereign Contracts is consistent with the requirements of Section 17A of the Act⁴ and regulations thereunder applicable to it, including the standards under Rule 17Ad-22.⁵ The amendments will provide for clearing of New Sovereign Contracts by ICE Clear Europe, consistent with ICE Clear Europe's existing clearing arrangements and related financial safeguards, protections and risk management procedures. ICE Clear Europe has adopted enhancements to the existing CDS Model to address the clearing of the New Sovereign Contracts, including the additional initial margin requirements under the qualitative and quantitative approaches to General Wrong Way Risk discussed above. The New Sovereign Contracts that will be cleared are Western European Sovereign CDS contracts substantially similar to other CDS contracts currently cleared by ICE Clear Europe. Acceptance of New Sovereign Contracts for clearing, on the terms and conditions set out in the

⁴ 15 U.S.C. 78q-1.

⁵ 17 CFR 240.17Ad-22.

ICE Clear Europe Rules and the enhanced CDS Model, is consistent with the prompt and accurate clearance of 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 and the protection of investors and the public interest, within the meaning of Section 17A(b)(3)(F) of the Act.⁶ Clearing of the New Sovereign Contracts will also satisfy the relevant requirements of Rule 17Ad-22,⁷ as discussed below.

Financial Resources. ICE Clear Europe will apply its existing margin methodology to the New Sovereign Contracts, with the enhancements to address General Wrong Way Risk discussed above. ICE Clear Europe believes that this model, including the additional initial margin that may be required to address General Wrong Way Risk, will provide sufficient margin to cover its credit exposure to its clearing members from clearing such contracts, consistent with the requirements of Rule 17Ad-22(b)(2) and Rule 17Ad-22(d)(14).⁸ In addition, ICE Clear Europe believes the CDS Guaranty Fund, under its existing methodology, will, together with the required margin, provide sufficient financial resources to support the clearing of New Sovereign Contracts consistent with the requirements of Rule 17Ad-22(b)(3).⁹

Operational Resources. ICE Clear Europe will have the operational and managerial capacity to clear the New Sovereign Contracts as of the commencement of clearing, consistent with the requirements of Rule 17Ad-22(d)(4).¹⁰ ICE Clear Europe believes that its existing systems are appropriately scalable to handle the additional New Sovereign Contracts, which are

⁶ 15 U.S.C. 78q-1(b)(3)(F).

⁷ 17 CFR 240.17Ad-22.

⁸ 17 CFR 240.17Ad-22(b)(2), (d)(14).

⁹ 17 CFR 240.17Ad-22(b)(3).

¹⁰ 17 CFR 240.17Ad-22(d)(4).

generally similar from an operational perspective to the CDS contracts currently cleared by ICE Clear Europe.

Settlement. ICE Clear Europe believes that the rule changes will be consistent with the requirements of Rule 17Ad-22(d)(5), (12) and (15)¹¹ as to the finality and accuracy of its daily settlement process and avoidance of the risk to ICE Clear Europe of settlement failures. ICE Clear Europe will use its existing settlement procedures, account structures and approved financial institutions as used in other CDS clearing for the New Sovereign Contracts. ICE Clear Europe believes that its Rules and procedures related to settlements (including physical settlements), appropriately identify and manage the risks associated with settlements under New Sovereign Contracts.

Default Procedures. ICE Clear Europe's existing Rules and default management policies and procedures for CDS will apply to the New Sovereign Contracts as well. ICE Clear Europe believes that the Rules and procedures allow for it to take timely action to contain losses and liquidity pressures and to continue meeting its obligations in the event of clearing member insolvencies or defaults, including in respect of New Sovereign Contracts, in accordance with Rule 17Ad-22(d)(11).¹²

Governance. ICE Clear Europe has determined to accept the New Sovereign Contracts for clearing in accordance with its governance process, including review of the contracts and related risk management considerations (and the enhancements to the margin methodology for General Wrong Way Risk discussed herein) by the CDS Risk Committee and approval by its Board. These arrangements are consistent with the requirements of Rule 17Ad-22(d)(8).¹³

¹¹ 17 CFR 240.17Ad-22(d)(5), (12) and (15).

¹² 17 CFR 240.17Ad-22(d)(11).

¹³ 17 CFR 240.17Ad-22(d)(8).

Although the General Wrong Way Risk approaches, when applied to all clearing members who clear the New Sovereign Contracts, may result in clearing members being subject to different margin charges based on their domicile and correlation with the underlying sovereign for a contract, ICE Clear Europe believes that the policy properly aligns the margin requirements to the risks presented by clearing members in this regard. The policy on General Wrong Way Risk has been established with well-defined, objective parameters and is applicable to all clearing members that choose to clear the New Sovereign Contracts. Further, ICE Clear Europe does not believe the revised margin methodology creates a conflict of interest between ICE Clear Europe and its clearing members or among clearing members. The revised margin methodology operates without the need for the CDS Risk Committee, ICE Clear Europe Board or management to exercise discretion concerning particular clearing members or the margin levels applicable to them. The qualitative and quantitative components to the methodology do not contain discretionary elements, and once the relevant threshold is exceeded, the clearing house is required under the policy to assess an additional initial margin charge based on the margin methodology. This approach should minimize any potential conflicts of interest. As noted above, the CDS Risk Committee and ICE Clear Europe management will regularly review the appropriateness of the quantitative threshold. Accordingly, the policy does not, in ICE Clear Europe's view, result in unfair discrimination among clearing members within the meaning of Section 17A(b)(3)(F) of the Act and Rule 17Ad-22(d)(8).¹⁴ ICE Clear Europe further notes that it has extensively consulted with its CDS Risk Committee as to this aspect of the clearing of the New Sovereign Contracts.

¹⁴ 15 U.S.C. 78q-1(b)(3)(F); 17 CFR 240.17Ad-22(d)(8).

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

ICE Clear Europe does not believe the proposed New Sovereign Contracts would have any impact, or impose any burden, on competition not necessary or appropriate in furtherance of the purpose of the Act. ICE Clear Europe does not anticipate that its commencement of clearing for the New Sovereign Contracts will adversely affect the trading market for those contracts or for CDS more generally. Specifically, allowing clearing of the New Sovereign Contracts will provide market participants with the additional choice to have their transactions in these types of contracts cleared, and should generally promote the further development of the market for these contracts. Moreover, ICE Clear Europe has established fair and objective criteria for eligibility to clear the New Sovereign Contracts, consistent with its criteria for other cleared CDS.

Although clearance of New Sovereign Contracts may result in an increase in margin requirements for some clearing members as a result of the General Wrong Way Risk requirements, ICE Clear Europe believes that these changes will properly align margin requirements to the risks presented by such clearing members with respect to the New Sovereign Contracts. As a result, ICE Clear Europe is of the view that these changes are necessary and appropriate in furtherance of the purpose of the Act and the Commission's regulations thereunder, including the financial resources and risk management requirements of Rule 17Ad-22.¹⁵ Furthermore, ICE Clear Europe does not believe that any such increase in margin requirements would significantly affect the ability of clearing members or other market participants to continue to clear CDS, consistent with the risk management requirements of the clearing house, or otherwise limit market participants' choices for selecting clearing services. Accordingly ICE Clear Europe does not believe that clearance of the New Sovereign Contracts

¹⁵ 17 CFR 240.17Ad-22.

will impose any burden on competition among clearing members not necessary or 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 current proposal for acceptance of the New Sovereign Contracts for clearing have not been solicited or received. One comment letter was received in connection with ICE Clear Europe's prior filing with respect thereto (File No. 2012-08), which suggested, in relevant part, consideration of additional wrong way risk raised by credit exposures of protection sellers to underlying sovereign reference entities. (The letter raised other issues concerning the disclosure of risk management processes generally and the effectiveness of market-standard sovereign CDS contracts as a hedge, which ICE Clear Europe believes are outside the scope of this rule change). ICE Clear Europe believes that the combination of the qualitative and quantitative approaches discussed herein provides appropriate initial margin protection for General Wrong Way Risk, and notes that ICE Clear Europe management and the CDS Risk Committee regularly review the appropriateness of the margin methodology. ICE Clear Europe will notify the Commission of any written comments received by ICE Clear Europe.

The CDS Risk Committee raised no objection to the clearing of the New Sovereign Contracts on the terms described herein on December 10, 2013. The clearing of the New Sovereign Contracts was approved by the ICE Clear Europe board on August 1, 2012.

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. Please include File Number SR-ICEEU-2014-04 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-2014-04. 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/notices/Notices.shtml?regulatoryFilings>.

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-2014-04 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.¹⁶

Kevin M. O'Neill
Deputy Secretary

[FR Doc. 2014-03973 Filed 02/24/2014 at 8:45
am; Publication Date: 02/25/2014]

¹⁶ 17 CFR 200.30-3(a)(12).