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SECURITIES AND EXCHANGE COMMISSION
[Release No. 34-87612; File No. SR-ICC-2019-013]

Self-Regulatory Organizations; ICE Clear Credit LLC; Notice of Filing of Proposed Rule Change Relating to the ICC Clearing Rules

November 25, 2019.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934, 15 U.S.C. 78s(b)(1) and Rule 19b-4, 17 CFR 240.19b-4, notice is hereby given that on November 15, 2019, ICE Clear Credit LLC (“ICE Clear Credit” or “ICC”) filed with the Securities and Exchange Commission the proposed rule change, security-based swap submission, or advance notice as described in Items I, II, and III below, which Items have been prepared primarily by ICC. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The principal purpose of the proposed rule change is to make certain changes to the ICC Clearing Rules (the “Rules”)¹ 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

¹ Capitalized terms used but not defined herein have the meanings specified in the Rules.

In its filing with the Commission, ICC included statements concerning the purpose of and basis for the proposed rule change, security-based swap submission, or advance notice and discussed any comments it received on the proposed rule change, security-based swap submission, or advance notice. The text of these statements may be examined at the places specified in Item IV below. ICC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of these statements.

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

(a) Purpose

ICE Clear Credit proposes amendments to its Rules 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 2019 Narrowly Tailored Credit Event Supplement to the 2014 ISDA Credit Derivatives Definitions (the “NTCE Supplement”).² 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

² The NTCE Supplement is published on the ISDA website at <https://www.isda.org/a/KDqME/Final-NTCE-Supplement.pdf>.

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.”³ 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 raise various issues under securities, derivatives, conduct and antifraud laws, as well as policy concerns.”⁴

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

³ NTCE Supplement, Guidance on the interpretation of the definition of “Failure to Pay”.

⁴ 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).

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 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 Credit 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 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 Credit is proposing to amend its Rules for relevant products to incorporate the NTCE Supplement, both for new and existing cleared transactions. For this purpose, the proposed ICC amendments will 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. ICC proposes to make such changes effective by the industry implementation date.

Specifically, ICC would amend Rule 20-102 to include new definitions for “NTCE Amending Contracts”, which would be those Contracts being amended to incorporate the NTCE Supplement, as specified in a list to be maintained by ICC, and “NTCE Effective Date”, which will be the date of implementation of the amendment. The NTCE Effective Date will initially be January 27, 2020 (or such later date as

designated by ICC by Circular). Rule 20-102 would also include a definition for the NTCE Supplement.

ICC would further amend each relevant subchapter of Chapter 26 of the Rules to implement the NTCE Supplement. A set of amendments would apply to index CDS transactions and a separate set of amendments would apply to single-name CDS transactions.

In the case of index CDS, for CDX.NA Index CDS transactions, in subchapter 26A, in Rule 26A-102, the definition of CDX.NA Untranching Terms Supplement would be amended to include the new 2020 standard terms supplement for such transactions, as published by ISDA, which incorporates the NTCE Supplement, along with conforming changes to cross-references. Rule 26A-316 would be amended by adding a new paragraph (e), which provides that open positions in CDX.NA Untranching Contracts that are NTCE Amending Contracts would be amended, effective as of the NTCE Effective Date, to reference the updated 2020 standard terms supplement in lieu of the standard terms supplement previously in effect. This will have the effect of converting all existing CDX.NA Untranching Contracts to reference the new standard terms supplement, such that they will be fungible with new CDX.NA Untranching Contracts, which will also reference the new standard terms supplement. New paragraph (e) would also provide that the amendments will be effective regardless of whether any transaction record in the Deriv/SERV warehouse is updated to reflect the change.

Substantially similar changes for other categories of index CDS would also be made in subchapters 26F (for iTraxx Europe Untranching Contracts) and 26J (for iTraxx Asia/Pacific Untranching Contracts).

In the case of single-name CDS, for Standard North American Corporate (SNAC) Contracts, in subchapter 26B, Rule 26B-616 would be amended by adding a new paragraph (c), which provides that open positions in SNAC Contracts that are NTCE Amending Contracts would be amended, effective as of the NTCE Effective Date, to incorporate the NTCE Supplement and specify that Fallback Discounting and Credit Deterioration Requirement will be applicable. The contracts would also be amended to reference the new ISDA physical settlement matrix, to be published as of the NTCE Effective Date (or other relevant implementation date as determined by ICC). The amendments will have the effect of converting existing SNAC Contracts to reference the updated physical settlement matrix, such that they will be fungible with new SNAC Contracts, which will also reference that matrix. New paragraph (c) would also provide that the amendments will be effective regardless of whether any transaction record in the Deriv/SERV warehouse is updated to reflect the change.

Substantially similar changes for other categories of single-name CDS would also be made in subchapters 26G (for Standard European Corporate Contracts), 26H (for Standard European Financial Corporate Contracts), 26M (for Standard Australian Corporate Contracts), 26N (for Standard Australia Financial Corporate Contracts), 26O (for Standard Asia Corporate Contracts), 26P (for Standard Asia Financial Corporate Contracts) and 26Q (for Standard Emerging Market Corporate Contracts).

(b) Statutory Basis

ICC believes that the proposed rule changes are consistent with the requirements of Section 17A of the Act⁵ and the regulations thereunder applicable to it, including the

⁵ 15 U.S.C. 78q-1.

applicable standards under Rule 17Ad-22.⁶ 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 ICC, the safeguarding of securities and funds in the custody or control of ICC or for which it is responsible, and the protection of investors and the public interest.⁷

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 Credit understands that for the uncleared swap market, these amendments are expected to be widely implemented through the NTCE Protocol. ICE Clear Credit 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.⁸ ICE Clear Credit is proposing to adopt amendments to its Rules to implement these same changes for both new and existing contracts cleared by it. As a result, in ICE Clear Credit's view, the amendments will enhance the integrity of the credit derivatives markets and the confidence of market participants in those markets,

⁶ 17 CFR 240.17Ad-22.

⁷ 15 U.S.C. 78q-1(b)(3)(F).

⁸ Update to June 2019 Joint CFTC-SEC-FCA Statement on Opportunistic Strategies in the Credit Derivatives Markets (Sept. 19, 2019).

and will therefore facilitate the prompt and accurate clearance and settlement of such contracts at ICC 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 Credit does not believe the amendments will materially affect the safeguarding of securities and funds in the custody or control of ICC or for which it is responsible.

The amendments will also satisfy relevant requirements of Rule 17Ad-22,⁹ as set forth in the following discussion.

Legal Framework. Rule 17Ad-22(d)(1) 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 of its activities in all relevant jurisdictions.”¹⁰ The amendments to the Rules 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, ICC believes that the amendments will enhance the legal framework for clearing of CDS Contracts, consistent with the requirements of Rule 17Ad-22(d)(1).¹¹

Operational Risk. Rule 17Ad-22(d)(4) requires a clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to “identify sources of operational risk and minimize them through the development of

⁹ 17 CFR 240.17Ad-22.

¹⁰ 17 CFR 240.17Ad-22(d)(1).

¹¹ 17 CFR 240.17Ad-22(d)(1).

appropriate systems, controls and procedures.”¹² ICC 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 ICC’s view, the amendments are consistent with the requirements of Rule 17Ad-22(d)(4).¹³

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

ICE Clear Credit 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. ICC’s specific amendments to its Rules will apply consistently across all Participants and Non-Participant Parties. ICC further expects that other market participants will make similar changes to their contracts and terms of trading. As a result, ICC does not expect that the proposed changes will adversely affect access to clearing or the ability of Participants, their customers or other market participants to continue to clear contracts, including CDS Contracts. ICC also does not believe the amendments would materially affect the cost of clearing or otherwise limit market Participants’ choices for selecting clearing

¹² 17 CFR 240.17Ad-22(d)(4).

¹³ 17 CFR 240.17Ad-22(d)(4).

services. Accordingly, ICC does not believe the amendments would impose any burden on competition not necessary or appropriate in furtherance of the purpose of the Act.

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

ICC has not solicited or received written comments with respect to the proposed rule changes. ICC will notify the Commission of any written comments on the proposed rule changes received by ICC.

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 such 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, security-based swap submission, or advance notice 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-ICC-2019-013 on the subject line.

Paper Comments:

Send paper comments in triplicate to , Secretary, Securities and Exchange Commission, 100 F Street, N.E., Washington, D.C. 20549.

All submissions should refer to File Number SR-ICC-2019-013. 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 Credit and on ICE Clear Credit's website at <https://www.theice.com/clear-credit/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-ICC-2019-013 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.¹⁴

Eduardo A. Aleman,
Deputy Secretary.

¹⁴ 17 CFR 200.30-3(a)(12).

