



SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-98570; File No. SR-ICEEU-2023-019]

Self-Regulatory Organizations; ICE Clear Europe Limited; Order Approving Proposed Rule Change Relating to Amendments to the Model Risk Policy

September 27, 2023.

I. Introduction

On August 4, 2023, ICE Clear Europe Limited (“ICE Clear Europe” or “the Clearing House”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”),¹ and Rule 19b-4,² a proposed rule change to amend its Model Risk Policy (the “Policy”). The proposed rule change was published for comment in the Federal Register on August 21, 2023.³ The Commission did not receive comments regarding the proposed rule change. For the reasons discussed below, the Commission is approving the proposed rule change.

II. Description of the Proposed Rule Change

A. Background

ICE Clear Europe is registered with the Commission as a clearing agency for the purpose of clearing security-based swaps. In its role as a clearing agency for security-based swaps, ICE Clear Europe maintains the Policy. The purpose of the Policy is to establish standards and principles for managing and mitigating the impact to ICE Clear Europe’s business caused by model error, model failure or inappropriate model use.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Self-Regulatory Organizations; ICE Clear Europe Limited; Notice of Filing of Proposed Rule Change Relating to Amendments to the Model Risk Policy, Exchange Act Release No. 98138 (August 15, 2023); 88 FR 56901 (August 21, 2023) (SR-ICEEU-2023-019) (“Notice”).

The proposed rule change would make updates and amendments to the Policy. ICE Clear Europe is making these changes to implement the results of internal and external reviews of the Policy. The Policy has five sections that address (1) the Purpose of the Policy, (2) Definitions, (3) Model Risk Governance, (4) Document Governance and Exception Handling, and (5) Version History. ICE Clear Europe proposes amendments to all five sections except for Document Governance and Exception Handling. ICE Clear Europe also proposes to update the Version History section to reflect these changes.

B. Purpose of the Policy

Section 1, “Purpose,” addresses the purpose, scope, and architecture of the Policy. In this section and throughout the Policy, ICE Clear Europe proposes to replace references to “Framework” with “Policy” and to include new language to expand the scope of the Policy to include risk frameworks used to quantify, aggregate, and manage the risks of the Clearing House. The amendments would further add language to clarify that references to “model” in the rest of the document would refer to both models and risk frameworks.

Section 1 also lists certain components that support the Policy. For example, ICE Clear Europe’s model inventory, schedule for model validations, and schedule for remediation of validation findings all support the Policy. The amendments would further add language to include on this list of supporting components guidelines for remediation of validation findings.

C. Definitions

Section 2, “Definitions,” describes in detail certain concepts that are used throughout the Policy, such as the meaning of the terms model and model risk, as well as the materiality of models, and significance of model changes. ICE Clear Europe proposes to amend the discussion of significance of model changes. The Policy currently states that only model changes are categorized into significant and not significant. ICE Clear Europe proposes to modify the Policy so that changes to both models and parameters, not just models, would be categorized as significant and not significant.

With respect to changes in parameters, ICE Clear Europe would further categorize these changes as Business as Usual (“BAU”) or non-BAU. Changes considered BAU would be defined as changes in the parameters resulting from the application of existing methodologies as part of a regular review or calibration exercise. Non-BAU changes would refer to all other changes. The amendments would clarify that the definition of BAU would be in accordance with existing regulatory guidelines.

Finally, the amendments would also update a footnote to remove a reference to a specific European Securities and Markets Authority opinion as providing the criteria defining model change significance. This footnote would be revised to state more generally that the criteria will be in accordance with prevailing regulatory opinions, guidelines, or requirements.

D. Model Risk Governance

Within Section 3, “Model Risk Governance,” ICE Clear Europe proposes to make amendments to the governance and responsibilities and model risk management subsections. In the governance and responsibilities subsection, the amendments would update the responsibilities of the Board of Directors (“Board”). Currently, the Board has several responsibilities, such as reviewing actions of the Model Oversight Committee and approving new material models and significant model changes for material models. The amendments would add to those responsibilities a new requirement for the Board to approve significant non-BAU changes to risk parameters.

The amendments would also add a footnote explaining the reasoning for the new responsibility. The footnote would state that the Auto Pilot versus Production deviations⁴ beyond BAU thresholds will generally follow a similar governance process to that for changes in parameters, but given that these deviations are usually time-sensitive and driven by stressed market conditions, the ability to act quickly to help ensure market stability is critical. This

⁴ Production deviations are categorized under significant non-BAU changes to risk parameters.

footnote only applies to specific margin updates for certain futures and options contracts and does not apply to any parameter updates for credit default swaps. Thus, for these situations, the governance process will involve Board notification rather than Board pre-approval, and Risk Oversight Department review rather than full independent pre-validation.

ICE Clear Europe proposes to add new responsibilities for the Model Oversight Committee as well. Under the proposed rule change, the Model Oversight Committee would be responsible for establishing and maintaining a model inventory and assigning a specific owner to each model (a function currently performed by the First Line of Defense).⁵ This function is currently performed by the First Line. The Model Oversight Committee would also be responsible for approving non-significant non-BAU changes to risk parameters, reviewing significant non-BAU changes to risk parameters for recommendation to the Board, and approving changes to model documentation. This is a new function currently not performed and is part of ICE Clear Europe's Policy expansion to distinguish between BAU and non-BAU parameter changes. ICE Clear Europe also proposes to modify the responsibilities of the First and Second Lines of Defense.⁶ The First Line would no longer be responsible for establishing and maintaining a model inventory and assigning a specific owner to each model, as that responsibility would be moved to the Model Oversight Committee. The amendments would include new responsibilities for the First Line, specifically, proposing and seeking approval for non-BAU changes to risk parameters (as it currently does for models, model changes, and model retirements) and proposing significance levels for non-BAU changes to risk parameters. Under the amendments, the Second Line would be responsible for performing independent validation exercises for non-BAU changes to risk parameters (as it currently does for models).

⁵ The business First Line includes models developed internally, third-party models, and models shared with other group entities, as well as risk frameworks used to quantify, aggregate, and manage the risks of the Clearing House.

⁶ The second line includes the Risk Oversight Department.

Finally, within the model risk management subsection, a new subsection would be added addressing non-BAU parameter changes. The section would provide that significant non-BAU changes to risk parameters must be validated before they are implemented in production.⁷ Non-significant non-BAU changes must be validated in accordance with the validation pipeline.

III. Discussion and Commission Findings

Section 19(b)(2)(C) of the Act directs the Commission to approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to such organization.⁸ For the reasons given below, the Commission finds that the proposed rule change is consistent with Section 17A(b)(3)(F) of the Act⁹ and Rules 17Ad-22(e)(2)(i) and (v), and (e)(3) thereunder.¹⁰

A. Consistency with Section 17A(b)(3)(F) of the Act

Section 17A(b)(3)(F) of the Act requires, among other things, that the rules of ICE Clear Europe be designed to promote the prompt and accurate clearance and settlement of securities transactions and, to the extent applicable, derivative agreements, contracts, and transactions.¹¹

As discussed above, the proposed rule change would modify the Policy. The Policy establishes standards and principles for managing and mitigating model risk for all product categories that ICE Clear Europe clears. The Commission believes that these changes, taken as a whole, would help ICE Clear Europe establish and maintain effective and functioning models. For example, by requiring parameters to be categorized as significant or not significant, the Commission believes that the proposed rule change would help ICE Clear Europe to identify and

⁷ As discussed above, in certain situations for certain futures and options contracts, Board notification rather than Board pre-approval is required.

⁸ 15 U.S.C. 78s(b)(2)(C).

⁹ 15 U.S.C. 78q-1(b)(3)(F).

¹⁰ 17 CFR 240.17Ad-22(e)(2)(i) and (v), and (e)(3).

¹¹ 15 U.S.C. 78q-1(b)(3)(F).

remediate possible errors in parameter changes before such changes are put into effect by allowing for more scrutiny for parameter changes. Because parameter changes can affect the function of ICE Clear Europe's models, the Commission further believes that doing so may help avoid the potential harm that could result from models that do not function properly, such as margin requirements that are not effective at mitigating risk. Similarly, the Commission believes that the proposed rule change, in making the Second Line responsible for independent validation of non-BAU changes to risk parameters, would help ensure that validations are completed objectively and competently because it brings additional scrutiny to model changes by adding additional levels of review. Biased or ineffective validations could miss potential errors in models and model changes. The Commission believes that this change may also help ICE Clear Europe avoid the potential harm that could result from models that do not function properly.

Given that ICE Clear Europe uses its margin and other models to manage and mitigate ICE Clear Europe's credit exposures to its Clearing Members and the risks associated with clearing security-based swap-related portfolios, the Commission believes that the proposed rule change would enhance ICE Clear Europe's ability to avoid losses that could result from the mismanagement of such credit exposures and risks. Because such losses could disrupt ICE Clear Europe's ability to promptly and accurately clear security-based swap transactions, the Commission believes that the proposed rule change would enhance ICE Clear Europe's ability to promote the prompt and accurate clearance and settlement of securities transactions.

Therefore, the Commission finds that the proposed rule change would promote the prompt and accurate clearance and settlement of securities transactions, consistent with the Section 17A(b)(3)(F) of the Act.¹²

¹² 15 U.S.C. 78q-1(b)(3)(F).

B. Consistency with Rules 17Ad-22(e)(2)(i) and (v)

Rules 17Ad-22(e)(2)(i) and (v) require that ICE Clear Europe establish, implement, maintain, and enforce written policies and procedures reasonably designed to provide for governance arrangements that are clear and transparent and specify clear and direct lines of responsibility.¹³

As discussed above, the proposed rule change would add a new requirement for the Board where it would be responsible for the approval of significant non-BAU changes to risk parameters. In doing so, the Commission believes that the Policy would clearly and transparently define who is responsible for this aspect of oversight of the Policy. The proposed rule change would also assign new responsibilities to the First and Second Lines. For example, the Second Line would be responsible for performing independent validation exercises for non-BAU changes to risk parameters, while the First Line would now be responsible for proposing and seeking approval for non-BAU changes to risk parameters.

The Commission believes the proposed rule change would improve the transparency of the governance related to the Policy by improving the relevant responsibilities for the development and validation of models and the review of the overall effectiveness of the Policy. The Commission believes these aspects of the Policy would also clearly define the responsibilities of the First and Second Lines.

Therefore, for the above reasons the Commission finds that the proposed rule change is consistent with Rules 17Ad-22(e)(2)(i) and (v).¹⁴

C. Consistency with Rule 17Ad-22(e)(3)

Rule 17Ad-22(e)(3) requires that ICE Clear Europe establish, implement, maintain, and enforce written policies and procedures reasonably designed to maintain a sound risk

¹³ 17 CFR 240.17Ad-22(e)(2)(i) and (v).

¹⁴ 17 CFR 240.17Ad-22(e)(2)(i) and (v).

management framework for comprehensively managing legal, credit, liquidity, operational, general business, investment, custody, and other risks that arise in or are borne by ICE Clear Europe. This includes risk management policies, procedures, and systems designed to identify, measure, monitor, and manage the range of risks that arise in or are borne by ICE Clear Europe, that are subject to review on a specified periodic basis and approved by the board of directors annually.¹⁵

As discussed above, the proposed rule change would add new requirements for the Model Oversight Committee so that it would be responsible for establishing and maintaining a model inventory and assigning a specific owner to each model. Additionally, the proposed rule change would add a requirement for significant non-BAU changes to risk parameters to be validated before they are implemented in production. In this way, the Commission believes the proposed rule change would help reduce model risk at ICE Clear Europe. Moreover, the Commission believes the proposed rule change would help ensure the objectivity and competence of validations by establishing a specific owner for each model. The Commission believes that competent and objective validations would, in turn, help to reduce model risk. Thus, the Commission believes that the proposed rule change would enable ICE Clear Europe to maintain a sound risk management framework for comprehensively managing its model risk.

Therefore, the Commission finds that the proposed rule change is consistent with Rule 17Ad-22(e)(3).¹⁶

¹⁵ 17 CFR 240.17Ad-22(e)(3).

¹⁶ 17 CFR 240.17Ad-22(e)(3).

IV. Conclusion

On the basis of the foregoing, the Commission finds that the proposed rule change is consistent with the requirements of the Act, and in particular, with the requirements of Section 17A(b)(3)(F) of the Act¹⁷ and Rules 17Ad-22(e)(2)(i) and (v), and (e)(3) thereunder.¹⁸

IT IS THEREFORE ORDERED pursuant to Section 19(b)(2) of the Act¹⁹ that the proposed rule change (SR-ICEEU-2023-019), be, and hereby is, approved.²⁰

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²¹

Sherry R. Haywood,

Assistant Secretary.

[FR Doc. 2023-21794 Filed: 10/2/2023 8:45 am; Publication Date: 10/3/2023]

¹⁷ 15 U.S.C. 78q-1(b)(3)(F).

¹⁸ 17 CFR 240.17Ad-22(e)(2)(i) and (v), and (e)(3).

¹⁹ 15 U.S.C. 78s(b)(2).

²⁰ 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).

²¹ 17 CFR 200.30-3(a)(12).