

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-85157; File No. SR-ICC-2019-002)

February 15, 2019

Self-Regulatory Organizations; ICE Clear Credit LLC; Notice of Filing of Proposed Rule Change Relating to ICC's Risk Parameter Setting and Review Policy

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934,<sup>1</sup> and Rule 19b-4,<sup>2</sup> notice is hereby given that on February 6, 2019, ICE Clear Credit LLC ("ICC") filed with the Securities and Exchange Commission the proposed rule change as described in Items I, II and III below, which Items have been prepared 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 revise the ICC Risk Parameter Setting and Review Policy ("Risk Parameter Policy"). These revisions do not require any changes to the ICC Clearing Rules ("Rules").

II. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, ICC 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. ICC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of these statements.

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

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

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

(a) Purpose

ICC proposes to formalize the Risk Parameter Policy that describes the process of setting and reviewing the risk management model (“model”) core parameters and the performance of sensitivity analyses related to certain parameter settings. ICC proposes to formalize the Risk Parameter Policy following Commission approval of the proposed rule change.

*Parameter Setting and Calibration*

ICC’s Risk Parameter Policy discusses the process of setting and reviewing the model core parameters and their underlying assumptions. The model requirements include bid/offer (“BO”) requirements, large position requirements, Jump-To-Default (“JTD”) requirements, interest rate (“IR”) sensitivity requirements, basis risk requirements, and integrated spread response (“iSR”) requirements. The parameters that are associated with the model requirements are listed in a table containing various parameter-related information, including the methods used to review parameter settings; the frequency of the reviews; and the groups involved in the review process (“reviewers”), such as the ICC Risk Management Department (“ICC Risk”), the Risk Working Group (“RWG”), or the Risk Committee. The parameters are described in more detail as follows.

The Risk Parameter Policy explains the process of setting and reviewing the liquidity charge parameters. The liquidity charge parameters are associated with BO requirements, also referred to as liquidity charges, which incorporate the transaction costs associated with liquidating the portfolio of a defaulting Clearing Participant (“CP”). With

respect to index instruments, the Risk Parameter Policy specifies how ICC Risk estimates the BO Widths (“BOWs”) for indices across volatile and extreme market conditions, in addition to how ICC Risk recognizes long-short benefits when computing portfolio-level index liquidity charges. In reference to single-name (“SN”) instruments, the Risk Parameter Policy introduces certain parameters to incorporate a price-based BOW component and a spread-based BOW component into the liquidity charge. The Risk Parameter Policy requires ICC to estimate and review the liquidity charge parameters at least monthly and summarizes the associated governance process, including the reviewers and any prerequisites to the implementation of parameter updates (e.g., review by the RWG or “no objection” ruling by the Risk Committee).

The Risk Parameter Policy discusses the estimation and the review of the concentration charge parameters, which are related to large position requirements. Large position requirements, also referred to as concentration charges, apply to positions that exceed a predefined notional amount threshold and increase as the amount above the threshold increases. The Risk Parameter Policy details how ICC Risk establishes series-specific or SN-specific concentration charge threshold levels for each index or SN Risk Factor (“RF”)<sup>3</sup>, and how ICC Risk estimates concentration charge growth rates that determine how quickly concentration charges increase with position size. The Risk Parameter Policy directs ICC to estimate and review the concentration charge parameters at least monthly and provides information on the corresponding governance process, stating the reviewers and any prerequisites to implementing parameter updates.

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<sup>3</sup> ICC deems each index, sub-index, or underlying SN reference entity a separate RF.

The parameters impacting the JTD requirement are categorized as either Loss-Given-Default (“LGD”) or Wrong-Way Risk (“WWR”) parameters. ICC’s risk management methodology incorporates considerations of idiosyncratic credit events and the associated potential losses. These credit event losses are termed LGD, and the Risk Parameter Policy discusses the determination and review of the associated LGD parameters. Specifically, the Risk Parameter Policy explains how, in order to measure credit event losses, ICC Risk constructs JTD scenarios in terms of anticipated recovery rate (“RR”) levels (“RR scenarios”). The Risk Parameter Policy references RR scenarios and estimations for corporate SNs, sectors, and sovereign reference entities, and notes foreign exchange rate risk considerations with respect to sovereign reference entities. Additionally, the LGD computations at the RF Group (“RFG”)<sup>4</sup> level depend on certain RFG-related parameters, which are specified in the Risk Parameter Policy. The Risk Parameter Policy requires ICC to estimate and review the LGD parameters at least monthly and describes the associated governance process, noting the reviewers and any prerequisites to the implementation of parameter updates.

The Risk Parameter Policy details the process of setting and reviewing the WWR parameters. WWR arises when there is a strong adverse correlation between a CP’s default risk and the occurrence of large losses in a CP’s portfolio. ICC considers three types of WWR: specific WWR (“SWWR”) results from self-referencing trades; General WWR (“GWWR”) results from trades that involve RFs within the sovereign and banking sectors that are highly correlated with the CP, or with an entity that is guaranteed by, or

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<sup>4</sup> ICC deems a set of SN RFs related by a common parental ownership structure a RFG.

affiliated with the CP; and Contagion WWR results from portfolio level aggregation of WWR exposure beyond a portfolio level WWR threshold. The Risk Parameter Policy contains information regarding the parameters that are used to quantify WWR dependence, compute WWR JTD requirements, and determine the level of WWR collateralization. The Risk Parameter Policy details the thresholds that are established as parameters for each RF generating WWR exposure, beyond which the increased level of WWR collateralization applies. Additionally, ICC estimates, reviews, and performs sensitivity analyses on the WWR parameters at least monthly, and the Risk Parameter Policy discusses the associated governance process, including the reviewers and any prerequisites to implementing parameter updates.

The Risk Parameter Policy contains information on the estimation and the review of the parameters that serve as inputs to the IR sensitivity requirement. The IR sensitivity requirement accounts for the risk associated with changes in the default-free discount term structure used to price CDS instruments. With respect to the IR sensitivity requirement parameters, the Risk Parameter Policy specifies how ICC Risk estimates the up and down parallel shifts for the US Dollar and Euro default-free discount term structures. The Risk Parameter Policy directs ICC to estimate and review the IR sensitivity requirement parameters at least monthly and specifies the corresponding governance process, noting the reviewers and any prerequisites to the implementation of parameter updates.

The Risk Parameter Policy discusses the setting and calibration of the parameters that are associated with the basis risk requirement. As index-derived SN positions and opposite “outright” SN positions are offset, the basis risk requirement is introduced to

capture the differences between the trading characteristics of index instruments and their replicating baskets of SN constituents. In reference to the basis risk requirement parameters, the Risk Parameter Policy discusses how ICC Risk estimates the basis between index spreads for each index family and the basis attributable to the fact that the index and the SNs may have different coupons. ICC estimates and reviews the basis risk requirement parameters at least monthly, and the Risk Parameter Policy details the corresponding governance process, specifying the reviewers and any prerequisites to implementing parameter updates.

The parameters impacting the iSR requirement, which captures credit spread and RR fluctuations, are classified as either univariate or multivariate level. The standardized distributions that describe the behavior of credit spread log-returns are characterized by certain univariate level iSR parameters that are specified in the Risk Parameter Policy. Moreover, the Risk Parameter Policy discusses the estimation of the univariate level iSR parameters, including by considering time series analysis of credit spread log-returns. The Risk Parameter Policy explains how different mean absolute deviation (“MAD”) estimates are obtained for each time series. In addition, the Risk Parameter Policy references the setting of the exponentially weighted moving average (“EWMA”) decay rate (“EWMA factor”), along with the estimation of certain RF-specific parameters describing the SN RR distributions. The Risk Parameter Policy requires ICC to estimate, review, and perform sensitivity analyses on the univariate level iSR parameters at least monthly and specifies the associated governance process, including the reviewers and any prerequisites to the implementation of parameter updates.

The Risk Parameter Policy contains information regarding the process of determining and reviewing the multivariate level iSR parameters. Using a simulation framework, ICC generates spread and RR scenarios by means of copulas to connect the univariate distributions that describe spread and RR fluctuations. The Risk Parameter Policy describes the multivariate parameters that serve as inputs to the copula simulations. Namely, the Risk Parameter Policy specifies the setting of a certain parameter to reflect tail dependence, a concept indicating the probability of extreme values occurring jointly. The Risk Parameter Policy also references the estimation of the Kendall tau rank-order correlations for the copula simulations. ICC estimates and reviews the multivariate level iSR parameters at least monthly, and the Risk Parameter Policy notes the corresponding governance process, including the reviewers.

#### *Sensitivity Analysis*

The Risk Parameter Policy details the sensitivity analyses that ICC Risk performs to explore the sensitivity of the risk management system's outputs to certain model core parameters that are calibrated on an ad-hoc basis and to alternative data analyses and parameter estimation techniques.

ICC conducts a sensitivity analysis on the univariate level iSR parameters by utilizing alternative techniques to estimate the parameters that fit the standardized distributions to the observed credit spread log-return data. The Risk Parameter Policy also considers the impact of the alternatively estimated parameters. This sensitivity analysis is reviewed with the RWG monthly and provides information if a change to the current estimation technique is considered. Further, the Risk Parameter Policy distinguishes two levels of sensitivity analyses, those that include a clearinghouse-wide

portfolio impact study and those, such as this one, that do not include a portfolio impact study.

ICC performs a sensitivity analysis, which does not include a portfolio impact study, by introducing different values for the EWMA factor. The Risk Parameter Policy discusses the impact of using different values for this univariate level iSR parameter and requires ICC to review this sensitivity analysis monthly with the RWG.

Under the Risk Parameter Policy, ICC carries out a sensitivity analysis on the routinely updated parameters. The Risk Parameter Policy identifies certain parameters that are updated routinely (i.e., daily or monthly) and are subject to a sensitivity analysis with a clearinghouse-wide portfolio impact study. The Risk Parameter Policy requires that the results of the proposed parameter updates are reviewed with the RWG prior to implementation and notes that this sensitivity analysis provides information regarding potential risk requirement changes due to routine parameter updates.

The portfolio benefits parameters are subject to a sensitivity analysis that includes a clearinghouse-wide portfolio impact study. Namely, ICC Risk estimates certain risk measures at pre-defined quantile levels by incorporating different dependence structures in order to guide ICC Risk in situations where back-testing results indicate excessive portfolio benefits. Under the Risk Parameter Policy, this sensitivity analysis is reviewed with the Risk Committee monthly.

Since the model allows the level of SWWR collateralization to be controlled by a model threshold, ICC conducts a sensitivity analysis for the SWWR threshold. ICC explores the maximum SWWR charges by requiring full collateralization of index-derived SWWR. This sensitivity analysis includes a clearinghouse-wide portfolio impact



study and guides ICC Risk when there is a decision to fully collateralize SWWR. Under the Risk Parameter Policy, this sensitivity analysis is reviewed with the Risk Committee monthly.

ICC performs a sensitivity analysis on MAD levels by shifting all MAD estimates to their stress levels to provide information about the response of risk requirements to potential volatility shifts and to assess the viability of certain parameter-setting assumptions. This sensitivity analysis includes a clearinghouse-wide portfolio impact study and is reviewed monthly with the Risk Committee.

ICC Risk performs a sensitivity analysis for the Guaranty Fund (“GF”) JTD configuration. ICC’s GF model aims to establish financial resources that are sufficient to cover hypothetical losses associated with simultaneous credit events where up to five SN RFGs are impacted. In that, two of the selected SN RFGs are CP SN RFGs (i.e., Cover-2 GF sizing) and the other three SN RFGs are non-CP RFGs. ICC considers an alternative where three of the selected SN RFGs are CP SN RFGs (i.e., Cover-3 GF sizing) and the other two are non-CP SN RFGs. This sensitivity analysis includes a clearinghouse-wide portfolio impact study, provides information when a change to the GF JTD configuration is considered, and is reviewed with the Risk Committee monthly.

(b) Statutory Basis

Section 17A(b)(3)(F) of the Act<sup>5</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

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<sup>5</sup> 15 U.S.C. 78q-1(b)(3)(F).

custody or control of the clearing agency or for which it is responsible; in general, to protect investors and the public interest; and to comply with the provisions of the Act and the rules and regulations thereunder. ICC believes that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to ICC, in particular, to Section 17(A)(b)(3)(F)<sup>6</sup>, because ICC believes that the proposed rule change to formalize the Risk Parameter Policy promotes the soundness of ICC's model. The Risk Parameter Policy describes ICC's process of setting and reviewing the model core parameters, in addition to the details surrounding ICC's performance of sensitivity analyses. The Risk Parameter Policy provides assurances as to the appropriateness of model core parameter settings and, accordingly, the appropriateness of margin requirements, thereby facilitating ICC's ability to promptly and accurately clear and settle its cleared CDS contracts; enhancing ICC's ability to assure the safeguarding of securities and funds which are in the custody or control of ICC or for which it is responsible; and protecting investors and the public interest. Moreover, ICC believes that having policies and procedures that clearly and accurately document ICC's process of setting and reviewing the model core parameters, along with ICC's performance of sensitivity analyses, is an important component to the effectiveness of ICC's risk management system, which promotes the prompt and accurate clearance and settlement of securities transactions, derivatives agreements, contracts, and transactions; the safeguarding of securities and funds which are in the custody or control of ICC or for which it is responsible; and the protection of investors and the public interest. As such, the proposed rule change is designed to promote the prompt and accurate clearance and

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<sup>6</sup> Id.

settlement of securities transactions, derivatives agreements, contracts, and transactions; to contribute to the safeguarding of securities and funds associated with security-based swap transactions in ICC's custody or control, or for which ICC is responsible; and, in general, to protect investors and the public interest within the meaning of Section 17A(b)(3)(F) of the Act.<sup>7</sup>

In addition, the proposed rule change is consistent with the relevant requirements of Rule 17Ad-22.<sup>8</sup> Rule 17Ad-22(b)(2)<sup>9</sup> requires ICC to establish, implement, maintain and enforce written policies and procedures reasonably designed to use margin requirements to limit its credit exposures to participants under normal market conditions and use risk-based models and parameters to set margin requirements and review such margin requirements and the related risk-based models and parameters at least monthly. Under the Risk Parameter Policy, ICC estimates and reviews the model core parameter settings at least monthly and performs and reviews sensitivity analyses related to certain parameter settings monthly. Such procedures serve to promote the soundness of ICC's model and to ensure that ICC's risk management system is effective and appropriate in addressing the risks associated with clearing security based swap-related portfolios. Namely, by requiring that ICC regularly review the model core parameter settings and sensitivity analyses related to certain parameter settings, the Risk Parameter Policy promotes ICC's use of margin requirements to limit its credit exposures to participants under normal market conditions and ICC's use of risk-based models and parameters to

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<sup>7</sup> Id.

<sup>8</sup> 17 CFR 240.17Ad-22.

<sup>9</sup> 17 CFR 240.17Ad-22(b)(2).

set margin requirements and review such margin requirements and the related risk-based models and parameters at least monthly, consistent with Rule 17Ad-22(b)(2).<sup>10</sup>

Rule 17Ad-22(b)(3)<sup>11</sup> requires ICC to establish, implement, maintain and enforce written policies and procedures reasonably designed to maintain sufficient financial resources to withstand, at a minimum, a default by the two CP families to which it has the largest exposures in extreme but plausible market conditions. The Risk Parameter Policy assures the appropriateness of model core parameter settings through a regular review process involving various reviewers, which supports ICC's ability to maintain sufficient margin requirements and enhances ICC's approach to identifying potential weaknesses, thereby ensuring that ICC continues to maintain sufficient financial resources to withstand, at a minimum, a default by the two CP 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>12</sup>

Rule 17Ad-22(d)(8)<sup>13</sup> requires ICC to establish, implement, maintain and enforce written policies and procedures reasonably designed to have governance arrangements that are clear and transparent to fulfill the public interest requirements in Section 17A of the Act.<sup>14</sup> The Risk Parameter Policy clearly assigns and documents responsibility and accountability for the estimation and review of the model core parameters and the

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<sup>10</sup> Id.

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

<sup>12</sup> Id.

<sup>13</sup> 17 CFR 240.17Ad-22(d)(8).

<sup>14</sup> 15 U.S.C. 78q-1.

performance of sensitivity analyses. Moreover, the Risk Parameter Policy describes the methods used to review parameter settings and perform sensitivity analyses, the frequency of the reviews, the groups involved in the review process, and any prerequisites to implementing parameter updates. These governance arrangements are clear and transparent, such that information relating to the assignment of responsibilities and the requisite involvement of ICC Risk, the RWG, and the Risk Committee is clearly documented, consistent with the requirements of Rule 17Ad-22(d)(8).<sup>15</sup>

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

ICC does not believe the proposed rule change would have any impact, or impose any burden, on competition. The proposed change to formalize the Risk Parameter Policy will apply uniformly across all market participants. Therefore, ICC does not believe the proposed rule change imposes any burden on competition that is inappropriate in furtherance of the purposes of the Act.

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

Written comments relating to the proposed rule change have not been solicited or received. ICC will notify the Commission of any written comments received by ICC.

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<sup>15</sup> 17 CFR 240.17Ad-22(d)(8).

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 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-ICC-2019-002 on the subject line.

Paper Comments:

Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

All submissions should refer to File Number SR-ICC-2019-002. 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 am and 3:00 pm. 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-2019-002 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>16</sup>

Eduardo A. Aleman  
Deputy Secretary

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<sup>16</sup> 17 CFR 200.30-3(a)(12).