

August 30, 2019

Self-Regulatory Organizations; ICE Clear Credit LLC; Order Approving Proposed Rule Change Relating to the ICC Clearing Participant Default Management Procedures and ICC Risk Management Framework

I. Introduction

On June 28, 2019, ICE Clear Credit LLC (“ICC”) filed with the Securities and Exchange Commission pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”),¹ and Rule 19b-4 thereunder,² a proposed rule change (SR-ICC-2019-008) to formalize and enhance the ICC Clearing Participant (“CP”) Default Management Procedures (“Default Management Procedures”) and enhance its Risk Management Framework.³ The proposed rule change was published in the Federal Register on July 16, 2019.⁴ The Commission did not receive comments on the proposed rule change. For the reasons discussed below, the Commission is approving the proposed rule change.

II. Description of the Proposed Rule Change

Currently, ICC’s default management rules and procedures are set forth throughout several documents, including the ICC Rules, the Default Auction Procedures -

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Capitalized terms used herein but not otherwise defined have the meaning set forth in the Default Management Procedures, the Risk Management Framework and ICE Clear Credit rulebook, which is available at <https://www.theice.com/clear-credit/regulation>.

⁴ Securities Exchange Act Release No. 34- 86341 (July 10, 2019), 84 FR 34021 (July 16, 2019) (SR-ICC-2019-008) (“Notice”).

Initial Default Auctions, and the Secondary Auction Procedures.⁵ In addition, Appendix 3 to the Risk Management Framework (“Appendix 3”) includes a high-level, general description of ICC’s overall default management procedures, with citations and cross-references throughout to the documents described above. The proposed rule change would (i) formalize and enhance ICC’s existing Default Management Procedures by creating a stand-alone document that replaces, restates, and substantially expands existing Appendix 3; (ii) within the new Default Management Procedures, provide additional detail and description with respect to ICC’s existing rules and procedures; and (iii) make related enhancements to the Risk Management Framework by incorporating appropriate references to the proposed stand-alone Default Management Procedures and making targeted changes clarifying guarantee fund replenishment and assessment contributions. The proposed Default Management Procedures would identify, describe, and provide additional detail with respect to ICC’s existing default management rules and procedures, but would not make substantive changes to any of those existing default management rules and procedures, which would still reside in the ICC Rules and other locations.

A. Default Management Procedures

The proposed Default Management Procedures would identify and describe ICC’s overall default management process, including (i) the actions that ICC will take to determine if a CP is in default and (ii) the actions ICC will take in connection with such a default and to close-out the defaulting CP’s positions. In describing ICC’s overall default management process, the Default Management Procedures would restate and substantially expand Appendix 3, but would not substantively change or otherwise

⁵ Notice, 84 FR at 34021.

replace ICC’s existing default management rules and procedures. Where appropriate, the proposed new stand-alone Default Management Procedures would cross-reference and cite to ICC’s existing default management rules and procedures to avoid duplication, and as discussed below, in some instances clarify and enhance them by, for example, providing additional detail, such as assigning responsibility for default management actions and adding instructions on how to perform default management actions.⁶ In describing the actions ICC will take to determine if a CP is in default and, subsequently, in connection with such a default, the Default Management Procedures document includes a list of defined terms that are key for default management and an overview of ICC’s default management process. In describing and providing an overview of ICC’s default management process, the proposed Default Management Procedures include descriptions of sub-processes such as identifying those clearing members that are at risk of defaulting or are in default, declaring a default, transferring a defaulter’s client portfolios to non-defaulting Futures Commission Merchants (“FCM”), consulting with the CDS Default Committee, performing Standard Default Management Actions and Secondary Default Management Actions to facilitate Close-Out, and managing default resources.⁷ Further, the Default Management Procedures describe how ICC and its CPs maintain operational readiness to execute the default management process, including administering the CDS Default Committee rotation process, working with customers of

⁶ Id.

⁷ Notice, 84 FR at 34021-34023.

CPs who want to directly participate in auctions, maintaining up-to-date contact information, and testing the default management process.⁸

The Default Management Procedures would also describe the sub-process of monitoring CPs. As part of a counterparty monitoring program, ICC performs daily, weekly, and quarterly monitoring designed, in part, to identify Default Risk CPs.⁹ Additionally, the Default Management Procedures establish procedures that are specific to certain types of defaults and circumstances, including where a CP fails to meet payment obligations to ICC; a CP has filed for bankruptcy or is likely to fail to meet obligations due to dissolution, insolvency, or bankruptcy related events; a CP has not complied, or is likely not to comply, with certain limitations, conditions, or restrictions imposed on it by ICC; and a CP or its guarantor has failed, or is likely to fail, to meet obligations of ICC membership.¹⁰

The actions taken after the identification of a potential default are the default declaration sub-process and the Default Management Procedures list actions that the Close-Out Team performs after activation but before a default declaration, such as initial meetings to discuss circumstances surrounding the default risk, strategy for the close-out, and plans for ICC to meet upcoming payment obligations.¹¹ The Default Management

⁸ Notice, 84 FR at 34022.

⁹ Id.

¹⁰ Id.

¹¹ Id.

Procedures also contain procedures taken after declaration of default to prepare for a close-out.¹²

The Default Management Procedures also discuss the CDS Default Committee consultation sub-process. Certain matters are subject to consultation with the CDS Default Committee, including the unwinding of the defaulter's remaining portfolio and the structure and characteristics of an auction.¹³ The Default Management Procedures establish procedures for convening and adjourning a CDS Default Committee meeting in addition to the actions taken at the initial CDS Default Committee meeting, which include reviewing the defaulter's cleared portfolio, the Close-Out strategy, the plan for transferring the Porting Portfolios to Potential Receiving FCMs, and a schedule for re-convening the CDS Default Committee over the period required to complete the Close-Out.¹⁴

The ICC Risk Department and Close-Out Team work together, in consultation with the CDS Default Committee, to implement the Close-Out strategy through Standard Default Management Actions.¹⁵ Specifically, the Default Management Procedures incorporate instructions on executing Initial Cover Transactions by auction and bilaterally, conducting Initial Default Auctions, and executing bilateral direct liquidation transactions in the market to liquidate positions.¹⁶ The document further assigns

¹² Id.

¹³ Id.

¹⁴ Id.

¹⁵ Id.

¹⁶ Id.

responsibility for tracking the position changes that result from the movement of positions or the creation of new positions.¹⁷

In addition to Standard Default Management Actions, ICC may take Secondary Default Management Actions to facilitate the Close-Out where default resources are significantly depleted or no default resources remain.¹⁸ ICC may call for assessment contributions and the Default Management Procedures discuss the procedures for calling for assessment contributions and initiating a Cooling-Off Period.¹⁹ During the Cooling-Off Period, the Risk Department and Close-Out Team, in consultation with the CDS Default Committee, continue to try to liquidate the defaulter's remaining portfolio through Secondary Auctions.²⁰ If available default resources are exhausted and ICC has not returned to a matched book, the Close-Out Team uses reasonable efforts to consult with the Risk Committee and then seeks the Board's decision on whether to enter a Loss Distribution Period, execute a partial tear-up, or terminate clearing services, which are detailed in the Default Management Procedures.²¹

Further, the Default Management Procedures provide an overview of the post-default porting sub-process.²² The Risk Department, in consultation with the CDS Default Committee, determine which Porting Portfolios to try to transfer to Potential

¹⁷ Id.

¹⁸ Id.

¹⁹ Id.

²⁰ Id.

²¹ Id.

²² Notice, 84 FR at 34023

Receiving FCMs.²³ The Default Management Procedures also discuss specific procedures for post-default porting in the case of a bankruptcy-related default, which require ICC to communicate and coordinate with the defaulter's trustee in bankruptcy.²⁴

The Default Management Procedures set forth the default resource management sub-process.²⁵ The document includes procedures for the identification and execution of collateral management activities that are necessary for ICC to meet upcoming payment obligations.²⁶ The Close-Out Team meets daily during the Close-Out Period to review the available liquid resources and determine how to meet upcoming payment obligations.²⁷ The Chief Operating Officer and Head of Treasury coordinate the execution of collateral management activities, including liquidating non-cash collateral in the defaulter's house and/or client accounts or utilizing ICC's committed FX or committed repo facilities.²⁸ Further, the Default Management Procedures describe the maintenance of a Default Management Ledger, which serves as a record to facilitate decision making and implement ICC's default waterfall; the discussion points during the Close-Out Team's daily meeting during the Close-Out Period; and the application of any special payments during the Close-Out Period.²⁹

²³ Id.

²⁴ Id.

²⁵ Id.

²⁶ Id.

²⁷ Id.

²⁸ Id.

²⁹ Id.

B. Risk Management Framework

ICC is proposing related default management enhancements to the Risk Management Framework. Specifically, ICC proposes to incorporate a reference to the Default Management Procedures in the ‘Governance and Organization’ section of the Risk Management Framework to specify that the Default Management Procedures contain details regarding default management roles and responsibilities of the Board, ICC management, and relevant committees.³⁰ Additionally, ICC proposes changes to the ‘Waterfall Level 6: GF Replenishment’ sub-section to more clearly describe CPs’ obligations with respect to replenishment and assessment contributions to the Guarantee Fund (“GF”). The proposed edits provide additional detail regarding the aggregate liability of CPs for replenishment and assessment contributions. Specifically, the edits clarify that if the cap on the additional GF contributions is reached, ICC may apply additional Initial Margin (“IM”) requirements if necessary to maintain compliance with regulatory financial resources requirements.³¹ The proposed changes further discuss how the additional IM requirements are computed and communicated to CPs.³² ICC also proposes to clarify the maximum contribution of a retiring CP that has given notice of its intent to terminate its CP status.³³ Finally, because the proposed Default Management Procedures would restate and substantially expand existing Appendix 3 of the Risk Management Framework, ICC proposes to remove Appendix 3 and replace a reference to

³⁰ Id.

³¹ Id.

³² Id.

³³ Id.

it in the Risk Management Framework with a reference to the Default Management Procedures instead.³⁴

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.³⁵ For the reasons given below, the Commission finds that the proposed rule change is consistent with Section 17A(b)(3)(F) of the Act³⁶ and Rules 17Ad-22(b)(3),³⁷ 17Ad-22(d)(4),³⁸ 17Ad-22(d)(8),³⁹ and 17Ad-22(d)(11)⁴⁰ thereunder.

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 ICC be designed to promote the prompt and accurate clearance and settlement of securities transactions and, to the extent applicable, derivative agreements, contracts, and transactions, as well as to assure the safeguarding of securities and funds which are in the

³⁴ Id.

³⁵ 15 U.S.C. 78s(b)(2)(C).

³⁶ 15 U.S.C. 78q-1(b)(3)(F).

³⁷ 17 CFR 240.17Ad-22(b)(3).

³⁸ 17 CFR 240.17Ad-22(d)(4).

³⁹ 17 CFR 240.17Ad-22(d)(8).

⁴⁰ 17 CFR 240.17Ad-22(d)(11).

custody or control of ICC or for which it is responsible, and, in general, to protect investors and the public interest.⁴¹

The Commission believes that by creating a stand-alone document that (i) formalizes and enhances ICC's existing default management procedures; (ii) identifies and cross-references the existing default management rules and procedures that currently are located in several other ICC documents; and (iii) describes the sub-processes involved in, and parties responsible for, those default management procedures, the proposed rule change would provide additional clarity, transparency, and detail with respect to ICC's default management procedures, which in turn would help promote prompt and accurate clearance settlement and the safeguarding of securities and funds in ICC's control. Specifically, the Default Management Procedures describe several default management sub-processes and the parties responsible. As described above, ICC consults with the CDS Default Committee, whose membership consists of experienced trading personnel at CDS clearing participants, prior to taking default actions. Further, the Default Management Procedures describe that the ICC President may activate the team responsible for overseeing the default management process, the Close-Out Team, as well as the various processes for managing default such as the counterparty monitoring process, default declaration process, and the standard and secondary default management actions. The Commission believes that these processes provide ICC the ability to regularly (daily, weekly, and quarterly) monitor those clearing participants at risk of default, develop default management strategies (standard or secondary), and execute default management actions (i.e., auctions, tear-ups). The Commission believes that this

⁴¹ 15 U.S.C. 78q-1(b)(3)(F).

formalized process for dealing with defaults before and after their declaration prepares ICC with assigned personnel and requisite strategies for effectively managing defaults. This level of detail in turn could help enhance ICC's ability to manage losses and thus maintain adequate financial resources necessary to promptly and accurately clear securities transactions and safeguarding of securities and funds in its custody and control.

Similarly, the Commission believes that the proposed changes to the Risk Management Framework support ICC's ability to maintain adequate financial resources. As described above, the changes to the Risk Management Framework more clearly describe CPs' obligations with respect to replenishment and assessment contributions to the guarantee fund, and provide additional detail regarding the aggregate liability of CPs for replenishment and assessment contributions. Further, the proposed changes clarify that if the cap on the additional GF contributions is reached, ICC may apply additional IM requirements if necessary to maintain compliance with regulatory financial resources requirements, and further discuss how the additional IM requirements are computed and communicated to CPs. ICC also proposes to clarify the maximum contribution of a retiring CP that has given notice of its intent to terminate its CP status. The Commission believes that by revising the Risk Management Framework with this additional detail, ICC will ensure that it has the procedures in place to obtain additional resources when necessary, thereby strengthening its financial position and ability to promptly and accurately clear securities transactions and safeguard funds and securities in its custody or control. Therefore, the Commission believes that the proposed rule changes are consistent with Section 17A(b)(3)(F) of the Act.

B. Consistency with Rule 17Ad-22(b)(3)

Rule 17Ad-22(b)(3) requires that ICC 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 participant families to which it has the largest exposures in extreme but plausible market conditions, in its capacity as a central counterparty for security-based swaps.⁴²

As described above, the proposed rule change would provide detailed instructions for managing defaults. Specifically, the Default Management Procedures discuss the responsible parties and actions taken prior and in response to a default. The proposed rule change describes ICC's counterparty monitoring program in which it performs daily, weekly, and quarterly monitoring designed, in part, to identify Default Risk CPs. The Commission believes that by formalizing procedures in this way ICC strengthens its ongoing system for detecting and coping with financial stress brought on by CP defaults and enhances its ability to manage its financial resources to cope with events such as a default by the two participant families to which it has the largest exposures in extreme but plausible market conditions.

Additionally, as stated above, ICC's Default Management Procedures would describe a variety of tools for dealing with defaults, for example, unwinding a defaulter's position and structuring an auction or executing bilateral direct liquidation transactions in the market; calling for assessment contributions from CPs to the guarantee fund; implementing reduced gains distributions; or executing a partial tear-up when available default resources are exhausted. Further, the Default Management Procedures set forth the process for default resource management, which involves the identification and

⁴² 17 CFR 240.17Ad-22(b)(3).

execution of collateral management necessary for meeting upcoming payment obligations. As mentioned above, liquid resources are reviewed and decisions are made as to whether to liquidate non-cash collateral in the defaulter's house and/or client accounts or to use ICC's committed FX and repo facilities. The Commission believes that these procedures offer tools to strengthen ICC's ability to manage its financial resources and withstand the pressures of defaults. Consequently, the Commission believes that the proposed rule change as relates to the Default Management Procedures is consistent with the obligations of Rule 17Ad-22(b)(3).

Similarly, the Commission believes that the proposed enhancements to the Risk Management Framework will strengthen ICC's ability to maintain sufficient financial resources to withstand a default by the two participant families to which it has the largest exposures in extreme but plausible market conditions. In particular, as described above, ICC proposes to more clearly describe a CP's obligations with respect to replenishment and assessment contributions to the GF. The proposed edits provide additional detail regarding the aggregate liability of CPs for replenishment and assessment contributions. If the cap on the additional GF contributions is reached, ICC may apply additional IM requirements if necessary to maintain compliance with regulatory financial resources requirements. The proposed changes further discuss how the additional IM requirements are computed and communicated to CPs. ICC also proposes to clarify the maximum contribution of a retiring CP that has given notice of its intent to terminate its CP status. The Commission believes that these clarifications will enhance ICC's ability to obtain additional financial resources by making parties aware of their financial liabilities and will in turn help it withstand a default by the two participant families to which it has the

largest exposures in extreme but plausible market conditions. The Commission believes, therefore, that the changes to the Risk Management Framework are consistent with Rule 17Ad-22(b)(3).

C. Consistency with Rule 17Ad-22(d)(4)

Rule 17Ad-22(d)(4) requires ICC 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 appropriate systems, controls, and procedures; implement systems that are reliable, resilient and secure, and have adequate scalable capacity; and have business continuity plans that allow for timely recovery of operations and fulfillment of a clearing agency's obligations.⁴³

As discussed above, the Default Management Procedures describe how ICC conducts monitoring of CPs on a daily, weekly, and quarterly basis. The Commission believes that the activities, as well as others set forth in the Default Management Procedures, help ICC and its CPs maintain operational readiness to execute the default management process. For example, the document sets forth ICC's processes for carrying out an annual Default Test, reviewing the results of the annual Default Test, and maintaining up-to-date contact information for default contacts. Such testing and preparation allow ICC to identify sources of operational risk and minimize them through the development of appropriate systems, controls, and procedures and implement systems that are reliable, resilient and secure, and have adequate scalable capacity. Consequently, the Commission believes that the proposed rule change is consistent with Rule 17Ad-22(d)(4).

⁴³ 17 CFR 240.17Ad-22(d)(4).

D. Consistency with Rule 17Ad-22(d)(8)

Rule 17Ad-22(d)(8) requires, in relevant part, that 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 to support the objectives of owners and participants, and to promote the effectiveness of the clearing agency's risk management procedures.⁴⁴

As described above, the Default Management Procedures discuss the role of various parties, including ICC's President, Risk Committee, CDS Default Committee, and Board. In particular, upon identifying default risk CPs, the ICC President may take no action or activate the team responsible for overseeing the default management process, which is composed of ICC management, the ICC Risk Oversight Officer, and the most senior member of the Treasury Department and which comprise the Close-Out Team, to move forward with the process of declaring a default. Further, if available default resources are exhausted and ICC has not returned to a matched book, the Close-Out Team uses reasonable efforts to consult with the Risk Committee and then seeks the Board's decision on whether to engage in secondary default management actions such as entering a Loss Distribution Period, executing a partial tear-up, or terminating clearing services. The Default Management Procedures also provide an overview of the post-default porting sub-process in which the Risk Department, in consultation with the CDS Default Committee, determines which Porting Portfolios to try to transfer. The Commission believes that these procedures represent comprehensive governance

⁴⁴ 17 CFR 240.17Ad-22(d)(8).

arrangements that are clear and transparent and promote the effectiveness of the clearing agency's risk management procedures by laying out various responsibilities throughout the default management process. Therefore, the Commission believes that the rule proposal is consistent with Rule 17Ad-22(d)(8).

E. Consistency with Rule 17Ad-22(d)(11)

Rule 17Ad-22(d)(11) requires ICC to establish, implement, maintain and enforce written policies and procedures reasonably designed to make key aspects of the clearing agency's default procedures publicly available and establish default procedures that ensure that the clearing agency can take timely action to contain losses and liquidity pressures and to continue meeting its obligations in the event of a participant default.⁴⁵

The Commission believes that because ICC's default management rules and procedures contained in the ICC Rules, the Default Auction Procedures - Initial Default Auctions, and the Secondary Auction Procedures are publically available on ICC's website and because the proposed Default Management Procedures clarify and augment ICC's existing rules and procedures relating to default management, the proposed rule change is consistent with the requirement to make key aspects of the clearing agency's default procedures publicly available.

Additionally, because of the monitoring and governance procedures prior to and directly after a default described above, the Commission believes that the proposed rule changes are consistent with the requirement to establish default procedures that ensure that the clearing agency can take timely action to contain losses and liquidity pressures and to continue meeting its obligations in the event of a participant default. The

⁴⁵ 17 CFR 240.17Ad-22(d)(11).

Commission believes that the frequency of the monitoring system enhances ICC's ability to timely respond to default risk. Consequently, the Commission believes that the proposed rule change is consistent with Rule 17Ad-22(d)(11).

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 Act⁴⁶ and Rules 17Ad-22(b)(3), 17Ad-22(d)(4), 17Ad-22(d)(8), and 17Ad-22(d)(11) thereunder.⁴⁷

⁴⁶ 15 U.S.C. 78q-1(b)(3)(F).

⁴⁷ 17 CFR 240.17Ad-22(b)(3), 17 CFR 240.17Ad-22(d)(4), (8), and (11)

IT IS THEREFORE ORDERED pursuant to Section 19(b)(2) of the Act⁴⁸ that the proposed rule change (SR-ICC-2019-008) be, and hereby is, approved.⁴⁹

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁵⁰

Jill M. Peterson,
Assistant Secretary

⁴⁸ 15 U.S.C. 78s(b)(2).

⁴⁹ 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).

⁵⁰ 17 CFR 200.30-3(a)(12).