SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-89948; File No. SR-ICC-2020-010)

September 22, 2020

Self-Regulatory Organizations; ICE Clear Credit LLC; Order Approving Proposed Rule Change Relating to the ICC Risk Management Model Description

I. Introduction

On July 29, 2020, ICE Clear Credit LLC ("ICC") 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 make changes to ICC's Risk Management Model Description.[3] The proposed rule change was published for comment in the Federal Register on August 12, 2020.[4] 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

ICC is proposing to make changes to its Risk Management Model Description in connection with its proposed launch of the clearing of credit default index swaptions ("Index Swaptions").[5] ICC has previously filed with the Commission changes to certain other policies

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[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b-4.

[3] Capitalized terms used but not defined herein have the meanings specified in the Rules.

[4] Self-Regulatory Organizations; ICE Clear Credit LLC; Notice of Proposed Rule Change Relating to the ICC Risk Management Model Description, Exchange Act Release No. 89491 (August 6, 2020); 85 Fed. Reg. 48741 (August 12, 2020) (SR-ICC-2020-010) ("Notice).

[5] The description herein is substantially excerpted from the Notice.

and procedures related to the clearing of Index Swaptions (the "Swaption Rule Filings") in order to adopt or amend certain related policies and procedures in preparation for the launch of clearing of Index Swaptions.[6] The Swaption Rule Filings describe an Index Swaption as when one party (the "Swaption Buyer") has the right (but not the obligation) to cause the other party (the "Swaption Seller") to enter into an index credit default swap transaction at a pre-determined strike price on a specified expiration date on specified terms. In the case of Index Swaptions that would be cleared by ICC, the underlying index credit default swap would be limited to certain CDX and iTraxx Europe index credit default swaps that are accepted for clearing by ICC, and which would be automatically cleared by ICC upon exercise of the Index Swaption by the Swaption Buyer in accordance with its terms. As also described in the Swaption Rule Filings, ICC would not commence clearing of Index Swaptions until all such policies and procedures have been approved by the Commission or otherwise become effective. As such, ICC filed the proposed rule change as part of ICC's larger effort to adopt the necessary policies and procedures prior to the eventual launch of the clearing of Index Swaptions.

The proposed changes would amend the Risk Management Model Description to incorporate a stochastic implied mean absolute deviation ("MAD") feature in connection with the proposed launch of the clearing of Index Swaptions and make certain other minor clarification changes. Specifically, the proposed amendments would modify Section VII of the Risk Management Model Description to add a subsection on stochastic implied MAD modeling. In ICC-2020-002, which is one of the Swaption Rule Filings, ICC modified the integrated spread

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6 SEC Release No. 34-87297 (Oct. 15, 2019), 84 Fed. Reg. 56270 (Oct. 21, 2019) (SR-ICC-2019-007); SEC Release No. 34-89142 (June 24, 2020), 85 Fed. Reg. 39226 (June 30, 2020) (SR-ICC-2020-002); SEC Release No. 34-89436 (July 31, 2020), 85 Fed. Reg. 47827 (Aug. 6, 2020) (SR-ICC-2020-008).

response component of the margin model to incorporate an options-implied credit spread distribution, which includes a scale parameter related to the MAD implied from swaption prices ("implied MAD").[7] In the current proposed rule change, ICC proposes enhancements to its approach to feature a stochastic implied MAD, which would present a more advanced risk modeling technique for option instruments in rapidly changing market conditions and high-volatility market environments. Currently, the model assumes a static implied MAD formulation where the implied MAD scale does not change in response to the simulated underlying index levels.

Under the proposed changes, the risk methodology for clearing Index Swaptions would consider the risk arising from the joint fluctuations of the underlying index levels and the options implied MAD scales in proposed Subsection VII.3. ICC would identify and describe the distribution that the changes of the implied MAD scales associated with each option expiry follow. ICC would also discuss and provide the rationale for its selected parameter estimation approach. Specifically, ICC would set out how the distribution parameters are estimated for a set of implied MAD changes. The proposed changes further explain how ICC models the joint fluctuations of the underlying index levels and the options implied MAD scales. Proposed Figure 12 illustrates the simulation approach and is thus intended to replace Figure 11 in Subsection VII.2.2 that ICC proposes to remove. Relatedly, in Subsection VII.5.1.1 with respect to instrument profit/loss ("P/L") estimations for Index Swaptions, ICC proposes to add reference to notations related to the stochastic implied MAD from proposed Subsection VII.3.

[7] SEC Release No. 34-89142 (June 24, 2020), 85 Fed. Reg. 39226 (June 30, 2020) (SR-ICC-2020-002).

The rule proposal would also make minor clarification changes to the Risk Management Model Description. Specifically, the proposal would reference the clearinghouse in Subsection III.6 when describing from where certain data is obtained and to abbreviate the term 'mean absolute deviation' in Subsection VI.2. Because of the addition of Subsection VII.3, the proposal would therefore renumber the subsections in Section VII accordingly. Additionally, the proposal would make clarifications to a formula and its notes in Subsection VII.5.1.2 regarding risk factor P/L estimations, including with respect to the description of an alternative option position P/L computation, subsequent risk estimations and the addition of certain payments to portfolio requirements.

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 Act[9] and Rules 17Ad-22(e)(4)(ii) and 17Ad-22(e)(6)(i) 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 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

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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)(4)(ii) and 17 CFR 240.17Ad-22(e)(6)(i).

assure the safeguarding of securities and funds which are in the custody or control of ICC or for which it is responsible.[11]

As noted above, the proposed rule change would enable a stochastic implied MAD feature in the Risk Management Model Description in connection with the proposed launch of the clearing of Index Swaptions. The stochastic implied MAD approach considers the joint fluctuations of the underlying index levels and the options implied MAD scales, which is in contrast to the static implied MAD formulation where the implied MAD scale does not change in response to the simulated underlying index levels. The Commission believes that by adjusting its risk modeling to account for rapidly changing and highly volatile markets, ICC will enhance its ability to manage the participant default risk by taking into account changing market environments. The Commission also believes that the clarification updates foster more clear and up to date documentation, which will also enhance ICC's ability to manage risk.

The Commission believes that such enhancements to ICC's ability to manage default risk combined with more up to date documentation will consequently enhance its financial position by facilitating the collection of margin more precisely tailored to the risks of the relevant products and, therefore, promote its ability to manage the applicable credit exposures, thereby helping to ensure ICC's continued operations in the event of a default and to promote the prompt and accurate clearance and settlement of transactions. Similarly, the Commission believes that the more precisely tailored margin could, in turn, help reduce the amount of credit losses that would potentially be charged to non-defaulting members in the event of a default, thereby helping to ensure that ICC is able to safeguard securities and funds in its custody and control.

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[11] 15 U.S.C. 78q-1(b)(3)(F).

Therefore, the Commission believes that the proposed rule change is consistent with Section 17A(b)(3)(F) of the Act.[12]

B. Consistency with Rule 17Ad-22(e)(4)(ii)

Rule 17Ad-22(e)(4)(ii) requires each covered clearing agency to establish, implement, maintain, and enforce written policies and procedures reasonably designed to effectively identify, measure, monitor, and manage its credit exposures to participants and those arising from its payment, clearing, and settlement processes, including by maintaining additional financial resources at the minimum to enable it to cover a wide range of foreseeable stress scenarios that include, but are not limited to, the default of the two participant families that would potentially cause the largest aggregate credit exposure for the covered clearing agency in extreme but plausible market conditions.[13]

As noted above, the proposed rule change would modify the Risk Management Model Description to add a subsection on stochastic implied MAD modeling in which the risk methodology for clearing Index Swaptions would consider the risk arising from the joint fluctuations of the underlying index levels and the options implied MAD scales. The Commission believes that by incorporating these changes, ICC will be in a better position to anticipate risks in these products under more dynamic and volatile market conditions for the underlying indexes, thereby enhancing its ability to collect the appropriate margin and consequently cover a wide range of foreseeable stress scenarios that include, but are not limited to, the default of the two participant families that would potentially cause the largest aggregate credit exposure for the covered clearing agency in extreme but plausible market conditions. For

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12 15 U.S.C. 78q-1(b)(3)(F).

13 17 CFR 240.17Ad-22(e)(4)(ii).

these reasons, the Commission believes that the proposed rule change is consistent with Rule 17Ad-22(e)(4)(ii).[14]

C. Consistency with Rule 17Ad-22(e)(6)(i)

Rule 17Ad-22(e)(6)(i) requires each covered clearing agency to establish, implement, maintain, and enforce written policies and procedures reasonably designed to cover its credit exposures to its participants by establishing a risk-based margin system that, at a minimum, considers, and produces margin levels commensurate with, the risks and particular attributes of each relevant product, portfolio, and market. As noted above, the proposed rule change considers the relationship between the underlying index levels and the implied MAD scales and presents a more advanced risk modeling technique for option instruments in rapidly changing market conditions and high-volatility market environments. The Commission believes that by taking into account the market dynamics of the underlying index levels, the proposed change will enable ICC to produces margin levels commensurate with the risks and attributes of Index Swaptions. The Commission believes that the proposed rule change is therefore consistent with Rule 17Ad-22(e)(6)(i).[15]

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[14] Id.

[15] 17 CFR 240.17Ad-22(e)(6)(i).

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 Act[16] and Rules 17Ad-22(e)(4)(ii) and 17Ad-22(e)(6)(i) thereunder.[17]

IT IS THEREFORE ORDERED pursuant to Section 19(b)(2) of the Act[18] that the proposed rule change (SR-ICC-2020-010) be, and hereby is, approved.[19]

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[20]

J. Matthew DeLesDernier
Assistant Secretary

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16 15 U.S.C. 78q-1(b)(3)(F).

17 17 CFR 240.17Ad-22(e)(4)(ii) and 17 CFR 240.17Ad-22(e)(6)(i).

18 15 U.S.C. 78s(b)(2).

19 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).

20 17 CFR 200.30-3(a)(12).