

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-82313; File No. SR-ICEEU-2017-013)

December 13, 2017

Self-Regulatory Organizations; ICE Clear Europe Limited; Order Approving Proposed Rule Change Relating to the ICE Clear Europe Procyclicality Framework

I. Introduction

On October 23, 2017, ICE Clear Europe Limited (“ICE Clear Europe”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ and Rule 19b-4 thereunder,² a proposed rule change (SR-ICEEU-2017-013) to adopt a new policy framework for addressing the procyclicality (“Procyclicality Framework”) associated with its risk management policies. Specifically, the Procyclicality Framework would establish the risk appetite, monitoring and assessment, and management of procyclicality in the risk models used by ICE Clear Europe to manage default risk. The proposed rule change was published for comment in the Federal Register on November 7, 2017.³ 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

ICE Clear Europe proposed to adopt a Procyclicality Framework that is intended to set forth, generally, (1) the aspects of ICE Clear Europe’s risk policies that may exhibit procyclicality; (2) the manner in which ICE Clear Europe will assess procyclicality

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Securities Exchange Act Release No. 34-81994 (Nov. 1, 2017), 82 FR 51663 (Nov. 7, 2017) (SR-ICEEU-2017-013) (“Notice”).

(using both qualitative and a quantitative metrics); and (3) how ICE Clear Europe will take procyclicality into account with respect to its consideration of and response to emerging risks. ICE Clear Europe proposed to define “procyclicality” as the extent to which changes in market conditions can have an effect on a clearing member’s ability to manage its liquidity to meet ICE Clear Europe’s changing margin requirements.⁴

ICE Clear Europe represented that although it has in place certain measures intended to mitigate procyclicality, as required by the European Market Infrastructure Regulation,⁵ it proposed to implement the Procyclicality Framework in order to establish a more defined approach to assessing procyclicality in its risk management policies and procedures.⁶ In particular, ICE Clear Europe proposed to identify the risk management policies that may introduce procyclical concerns, which includes margin models, stress testing, and collateral haircut policies. In addition, as part of the Procyclicality Framework, ICE Clear Europe also proposed to reference existing methods for mitigating procyclicality in the above mentioned areas, as well as certain stress testing arrangements.⁷

Furthermore, ICE Clear Europe proposed to incorporate into the Procyclicality Framework the measures by which it would assess the level of procyclicality.

Specifically, ICE Clear Europe proposed to assess procyclicality by monitoring the 95th

⁴ Notice, 82 FR at 51663.

⁵ Article 28 of the Commission Delegated Regulation (EU) No 153/2013 of 19 December 2012 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on requirements for central counterparties.

⁶ Notice, 82 FR at 51663.

⁷ Id.

percentile expected shortfall of the 5-day percentage change in initial margin (or other relevant risk mitigant) over a rolling 250-day window. ICE Clear Europe represented that this metric would be used to measure short term spikes in margin.⁸ In addition, ICE Clear Europe would also take into consideration the largest percentage changes, and use these observations, as well as the estimates of the expected shortfall, to detect and remove extreme outliers from the data.

In the event procyclicality is identified using this measure, ICE Clear Europe proposed an escalation process that provides for review and response obligations.⁹ The nature of the response would vary based on predetermined thresholds for the expected 95th percentile expected shortfall metric described above.¹⁰

To further assess procyclicality, ICE Clear Europe also proposed to incorporate several qualitative factors into the Procyclicality Framework. These proposed qualitative factors include the periodicity of margin updates, the activities of other central counterparties in relevant markets, the expectations of market participants and related potential for moral hazard stemming from an expectation of gradual margin changes, and the ability of ICE Clear Europe to override, in extreme circumstances, standard measures designed to mitigate procyclicality.¹¹ Moreover, ICEEU proposed to take into account differences across markets when implementing measures intended to mitigate

⁸ Id.

⁹ Id.

¹⁰ Id.

¹¹ Notice, at 82 FR at 51664.

procyclicality, as well as the varying liquidity resources and practices of the different types of Clearing Members that use the services of ICE Clear Europe.¹²

With respect to future risk model design, ICE Clear Europe proposed to incorporate into the Procyclicality Framework a requirement that its model design process take into account any procyclicality characteristics that a model may exhibit, and that the model design process also take into account the impact of any steps designed to mitigate procyclicality.¹³

Finally, ICE Clear Europe proposed to include in the Procyclicality Framework consideration of the procyclicality of new products and procyclicality arising from material changes in existing products. ICE Clear Europe has represented that much of its Procyclicality Framework will be available on its website.¹⁴

III. Discussion and Commission Findings

Section 19(b)(2)(C) of the Act directs the Commission to approve a propose 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.¹⁵ Further, Section 17A(b)(3)(F) of the Act requires, among other things, that the rules of a registered 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

¹² Id.

¹³ Notice, 82 FR at 51663-64.

¹⁴ Id.

¹⁵ 15 U.S.C. 78s(b)(2)(C).

safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible, and, in general, to protect investors and the public interest.¹⁶ Rule 17Ad-22(e)(2) requires, in relevant part, that a covered clearing agency establish, implement, maintain, and enforce written policies and procedures reasonably designed to provide for governance arrangements that are clear and transparent, that clearly prioritize the safety and efficiency of the covered clearing agency, and that support the public interest requirements of Section 17A of the Act, applicable to clearing agencies, and the objectives of owners and participants.¹⁷

The Commission finds that the proposed rule change, which would implement a new Procyclicality Framework, is consistent with the requirements of Section 17A of the Act and the relevant provisions of Rule 17Ad-22 thereunder. By establishing a Procyclicality Framework that (1) identifies risk management policies and procedures exhibiting procyclicality, (2) establishes a measure for assessing procyclicality in such risk management policies and procedures, and (3) provides for a process requiring review and defined responses in the event that certain procyclicality thresholds are exceeded, the Commission believes that ICE Clear Europe will have an increased ability to identify, assess and respond to procyclicality that arises in connection with the clearing services it provides. Consequently, the Commission believes that the Procyclicality Framework will enhance ICE Clear Europe's ability to mitigate the risks associated with procyclicality, thereby facilitating ICE Clear Europe's collection of the appropriate level of resources to manage its risks in a variety of market conditions, including stressed market conditions.

¹⁶ 15 U.S.C. 78q-1(b)(3)(F).

¹⁷ 17 CFR 240.17Ad-22(e)(2).

This expected outcome, in turn, will permit ICE Clear Europe to provide prompt and accurate clearance and settlement of the products for which it offers clearing services, and more adequately protect its Clearing Members in the event of a default, which will enhance ICE Clear Europe's ability to safeguard the securities and funds which are in its custody or control. For these reasons, the Commission also believes that implementing the Procyclicality Framework is in the public interest. Therefore, the Commission finds that the proposed rule change implementing a new Procyclicality Framework is consistent with the requirements of Section 17A.

Additionally, by implementing the Procyclicality Framework, which includes a process for review and response to assessments of procyclicality based on quantitative and qualitative metrics and the relation of those metrics to predefined thresholds, and by publishing portions of the Procyclicality Framework on its website, the Commission believes that ICE Clear Europe is establishing policies and procedures that are consistent with the requirements of Rule 17Ad-22(e)(2).

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹⁸ that the proposed rule change (ICEEU-2017-013) be, and hereby, is approved.¹⁹

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

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Assistant Secretary

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).