

**SECURITIES AND EXCHANGE COMMISSION**  
Release No. 34-86783; File No. SR-ICEEU-2019-014

August 28, 2019

Self-Regulatory Organizations; ICE Clear Europe Limited; Order Approving Proposed Rule Change Relating to the ICE Clear Europe CDS Default Management Framework.

I. Introduction

On June 25, 2019, ICE Clear Europe Limited (“ICE Clear Europe,” the “Clearing House” or “ICEEU”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to revise its CDS Default Management Framework (the “Framework”). The proposed rule change was published for comment in the Federal Register on July 16, 2019.<sup>3</sup> 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’s proposed rule change would amend its Framework to be consistent with amendments to the ICE Clear Europe Clearing Rules (the “Rules”) to address default management, recovery and wind-down for the CDS Contract Category

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

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

<sup>3</sup> Securities Exchange Act Release No. 86340 (July 10, 2019), 84 FR 33996 (July 16, 2019) (SR-ICEEU-2019-014) (“Notice”).

(“Recovery Rule Amendments”).<sup>4</sup> The proposed changes to the Framework relate primarily to auction procedures, reduced gains distribution, partial tear-up, Clearing Member withdrawal and termination, clearing service termination, and governance during a default. The changes would incorporate, summarize, and reflect these aspects of the Recovery Rule Amendments. The proposed changes would also make various clarifying changes and corrections to typographical errors.<sup>5</sup>

A. Auction Procedures

In light of the Recovery Rule Amendments referenced above, the proposed rule change would revise several aspects of the Framework to adopt a set of new initial and secondary auction procedures. Specifically, the Framework amendments would do the following:

- clarify that in determining the auction portfolios, the Clearing House would consider wrong-way risk to non-defaulting Clearing Members, among other listed factors;
- clarify that upon completion of the auction, submission of resulting trade to the Trade Information Warehouse would be done under normal Clearing House practices;
- Clearing Members would no longer be required to confirm to the Default Management Committee their intention to bid in a particular auction;

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<sup>4</sup> File No. SR-ICEEU-2019-003.

<sup>5</sup> Capitalized terms used but not defined herein have the meanings specified in the ICE Clear Europe Clearing Rules or the Framework. The following description of the proposed rule change is excerpted from the Notice, 84 FR 33996.

- no longer provide that the last bid submitted by the Clearing Member is the only bid considered once the bidding window is closed;
- set a range for the minimum bid requirement for Clearing Members. The Framework provides examples of the calculation of the minimum bid requirement for Clearing Members, based on their respective CDS Guaranty Fund contributions as compared to the total CDS Guaranty Fund size;
- provide several examples of the modified Dutch auction methodology used under the Proposed Auction Procedures;
- reflect the two means by which Customers would be able to participate in auctions under the Proposed Auction Procedures: (i) via Clearing Member following mutual agreement on participation terms; and (ii) via direct participation following (subject to Customer contribution of €7.5 million to default resources (in the case of initial auctions) and certain other requirements);
- summarize key distinctions between initial auctions and secondary auctions under the Proposed Auction Procedures;
- delete the existing Clearing House approach to non-competitive bids, in light of the three tier methodology approach to juniorization of the Guaranty Fund contribution provided for in the Recovery Rule Amendments;
- remove the existing auction schedule in the Framework, as it would be superseded by the Proposed Auction Procedures; and
- remove the provisions in the existing Framework for forced portfolio allocation for positions for which ICE Clear Europe does not receive a formal bid from any

Non-Defaulting Clearing Members, consistent with the Recovery Rule Amendments.

B. Reduced Gains Distribution

The amendments would also add a new section to the framework that describes the use of reduced gains distribution (“RGD”) as a recovery tool. The Framework would incorporate and summarize key aspects of the Recovery Rule Amendments relating to the use of RGD, including the methodology for applying RGD to both the house and customer accounts and the five consecutive business day limitation on the use of RGD (following which partial tear-up may be conducted). The Framework would also provide examples of the use of RGD.

C. Partial Tear-Up

The amended Framework would reflect the Recovery Rule Amendments that permit the Clearing House to proceed to partial tear-up as a final default tool where the Clearing House is unable to close out all of the defaulter’s remaining positions through auctions within the Clearing House’s remaining resources. In a partial tear-up, the Clearing House would terminate positions of non-defaulting Clearing Members that exactly offset those in the defaulting Clearing Member’s remaining portfolio. The Framework would also describe procedures for the timing of partial tear-up and determination of the relevant termination price, in accordance with the Recovery Rule Amendments.

D. Clearing Member Withdrawal

The proposed amendments to the Framework would reflect the procedures for Clearing Member withdrawal as set out in the Recovery Rule Amendments, including

both an ordinary course of business termination outside of a default and termination during a cooling off period.

E. Clearing Service Termination

The amended Framework would also reflect the Clearing House's ability, under Rule 916 as proposed to be modified by the Recovery Rule Amendments, to terminate the CDS clearing service under specified circumstances.

F. Governance

Pursuant to the proposed amendments, the CDS Risk Committee would be consulted on establishing the terms of initial and secondary auctions (including defining different auction lots) and holding additional auctions and/or accepting a partial fill of an auction during the initial auction phase. The CDS Risk Committee would be consulted, with the ultimate decision to be made by the ICE Clear Europe Board (or their delegate), with respect to a number of matters, including:

- Whether to use CDS Guaranty Fund contributions of non-defaulting Clearing Members to cover the cost of a direct liquidation outside of a default auction;
- Whether to determine that an initial default auction has failed due to insufficient default resources;
- Whether to invoke and/or continue RGD;
- Whether to hold a secondary auction, whether that auction has failed and in the event of failure, whether to hold additional secondary auctions;
- In a secondary auction, whether to reallocate default resources to a particular lot to permit a successful auction of that lot;

- In a final secondary auction, whether to accept a “partial fill” to the extent of available default resources for the relevant lot;
- Whether to implement a partial tear-up;
- Whether to terminate the clearing service in full; and
- Whether to bypass an initial default auction or bypass secondary default management action(s).

#### G. Clarifying and Conforming Amendments

The Framework would also make clarifications and fix typographical errors. For example, the amendments would remove an unnecessary provision that hedging traders are responsible for ensuring all hedge trades are correctly reflected in the trade capture system by end of day (as the Clearing House is responsible for such matters in accordance with its current practices); remove unnecessary details about computer support for CDS Default Committee; remove an outdated trade workflow chart; clarify, consistent with current practice, that the Head of Clearing Risk may postpone the collateral sale with respect to liquidation of a defaulting Clearing Member’s collateral without seeking advice of the CDS Default Committee; clarify that the risk team also consults with the CDS Default Committee with respect to establishing hedging positions with the non-defaulting Clearing Members, in addition to the Head of Clearing Risk; and removing certain parts of Appendix A such as an itemized example of auction position data and a standard bidding template.

#### III. 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 the proposed rule change is

consistent with the requirements of the Act and the rules and regulations thereunder applicable to the organization presenting it.<sup>6</sup> For the reasons given below, the Commission finds that the proposed rule change is consistent with Section 17A(b)(3)(F) of the Act<sup>7</sup> and Rules 17Ad-22(e)(2) and (e)(13) thereunder.<sup>8</sup>

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, to assure the safeguarding of securities and funds which are in the custody or control of ICE Clear Europe or for which it is responsible, and, in general, to protect investors and the public interest.<sup>9</sup>

As discussed above, the proposed rule change would revise the Framework in order to conform it with recent changes to the Recovery Rule Amendments. Specifically, the proposed amendments would revise the Framework to include procedures for utilizing the default rules made available by the Recovery Rule Amendments. The Commission believes that by adding default procedures such as default auctions, RGDs, Clearing Member termination, and partial tear-up, ICEEU has included in its Framework multiple methods for managing losses and preserving resources in the default context.

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<sup>6</sup> 15 U.S.C. 78s(b)(2)(C).

<sup>7</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>8</sup> 17 CFR 240.17Ad-22(e)(2) and (e)(13).

<sup>9</sup> 15 U.S.C. 78q-1(b)(3)(F).

The Commission believes that this in turn will enhance ICEEU's ability to restore a matched book and limit its exposure to potential losses from clearing member defaults. For instance, the Commission believes that by amending the Framework to clarify that in determining auction portfolios, ICEEU will consider wrong-way risk to non-defaulting clearing members, ICEEU enables its auction procedures to cope with such risk. Additionally, by providing examples of a modified Dutch auction methodology, reflecting the two means by which customers would be able to participate in an auction, and summarizing the key distinctions between initial auctions and secondary auctions, the Commission believes that the Framework is enhanced by providing customers with enhanced detail and certainty regarding the auction procedures ICEEU would utilize under the Framework.

The Commission also believes that by adding detail about RGD in the Framework, ICEEU strengthens the Framework with a tool that could limit losses in the event of a default. For instance, RGD can be utilized to obtain financial resources from non-defaulting clearing members in the event default resources are insufficient, thereby forestalling the deterioration of the clearing house's financial condition. Likewise, revising the Framework to reflect the partial tear-up tool provides ICEEU a final recovery tool in the event that it is unable to clear out a defaulter's remaining positions through auctions, which the Commission believes could reduce further utilization of clearing house resources.

Further, the Commission believes that by including updated procedures reflecting the ability of clearing members to withdraw in both ordinary course and default situations, clearing members will be better informed regarding withdrawal procedures



and ICEEU will be better prepared to manage this eventuality. Likewise, the Commission believes that, by including procedures related to clearing service termination in its Framework, ICEEU will be more prepared to address general business risk and operational risk in an orderly fashion.

Taken together, the Commission believes that the proposed rule changes will enhance ICEEU's ability to preserve financial resources during default and address business and operational risk in an orderly manner, which in turn is consistent with Section 17A(b)(3)(F) of the Act's requirement for prompt and accurate settlement and safeguarding of securities and funds.

For these same reasons, the Commission also believes that the proposed rule change is, in general, consistent with the protection of investors and the public interest.

B. Consistency with Rule 17Ad-22(e)(2)

Rule 17Ad-22(e)(2) requires, in relevant part, 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 that specify clear and direct lines of responsibility.<sup>10</sup>

The Commission believes that the proposed rule change's description of the CDS Risk Committee and Board roles during a default event provide for governance arrangements that are clear and transparent and that specify clear and direct lines of responsibility. Specifically, the proposed rule change would revise the Framework to provide that the CDS Risk Committee would be consulted on establishing the terms of

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<sup>10</sup> 17 CFR 240.17Ad-22(e)(2).

initial and secondary auctions, holding additional auctions, and/or accepting a partial fill of an auction during the initial auction phase. Further, the CDS Risk Committee would be consulted (with final decision residing with the Board) with respect to a variety of default matters described above, including whether to use the Guaranty Fund contributions of non-defaulting clearing members to cover the liquidation costs outside of a default auction, to determine that an initial default has failed, to invoke or continue RGD, to hold a secondary auction, to reallocate default resources to a particular lot, to accept partial fills, to permit partial tear-ups, to terminate clearing services in full, or to bypass an initial or secondary auction management actions. Accordingly, the Commission believes that the proposed revisions to the Framework are reasonably designed to provide for governance arrangements that are clear and transparent and that specify clear and direct lines of responsibility.

C. Consistency with Rule 17Ad-22(e)(13)

Rule 17Ad-22(e)(13) requires ICE Clear Europe to, in relevant part, establish, implement, maintain and enforce written policies and procedures reasonably designed to ensure that it has the authority and operational capacity to take timely action to contain losses and liquidity demands and continue to meet its obligations.

By amending the Framework to include the new default management and recovery tools in the Recovery Rule Amendments, the Commission believes that the proposal is consistent with Rule 17Ad-22(e)(13) because the various recovery tools give ICEEU the authority and capacity to timely contain losses and liquidity demands. In particular, by adding to the Framework a new section that authorizes the use of RGD as a recovery tool applied to customer and house accounts in the event that its remaining

default resources are insufficient to ensure solvency, ICEEU would strengthen its ability to meet obligations in the event of a default by preserving its resources and limiting its obligations to clearing members. Similarly, the proposed amendments that permit ICEEU to proceed with a partial tear-up as a default tool when it is unable to close out all of a defaulter's remaining positions through auctions would also enhance ICEEU's ability to manage defaults by terminating positions of non-defaulters that exactly offset those in the defaulting clearing member's remaining portfolio and restore a matched book. The Commission believes that these tools, along with the Framework amendments discussed above, would promote ICEEU's ability to preserve its resources and timely meet its obligations in extreme default events and are therefore consistent with Rule 17Ad-22(e)(13).

#### 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<sup>11</sup> and Rules 17Ad-22(e)(2) and (e)(13) thereunder.<sup>12</sup>

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<sup>11</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>12</sup> 17 CFR 240.17Ad-22(e)(2) and (e)(13).

IT IS THEREFORE ORDERED pursuant to Section 19(b)(2) of the Act<sup>13</sup> that the proposed rule change (SR-ICEEU-2019-014) be, and hereby is, approved.<sup>14</sup>

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>15</sup>

Jill M. Peterson  
Assistant Secretary

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<sup>13</sup> 15 U.S.C. 78s(b)(2).

<sup>14</sup> 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).

<sup>15</sup> 17 CFR 200.30-3(a)(12).