

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-94607; File No. SR-ICEEU-2022-004)

April 5, 2022

Self-Regulatory Organizations; ICE Clear Europe Limited; Order Approving Proposed Rule Change Relating to Amendments to the ICE Clear Europe CDS Clearing Stress-Testing Policy and CDS Clearing Back-Testing Policy

I. Introduction

On February 10, 2022, 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 (the “Act”),¹ and Rule 19b-4 thereunder,² a proposed rule change to amend its CDS Clearing Back-Testing Policy (“CDS Back-Testing Policy”) and CDS Clearing Stress-Testing Policy (“CDS Stress-Testing Policy”). The proposed rule change was published for comment in the Federal Register on February 25, 2022.³ The Commission did not receive comments regarding the proposed rule change. For the reasons discussed below, the Commission is approving the proposed rule change.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Self-Regulatory Organizations; ICE Clear Europe Limited; Notice of Filing of Proposed Rule Change Relating to Amendments to the ICE Clear Europe CDS Clearing Stress Testing Policy and CDS Clearing Back-Testing Policy, Exchange Act Release No. 94280 (Feb. 18, 2022); 87 Fed. Reg. 10878 (Feb. 25, 2022) (SR-ICEEU-2022-004) (“Notice”).

II. Description of the Proposed Rule Change

The proposed rule change would amend the CDS Clearing Back-Testing Policy and CDS Clearing Stress-Testing Policy to remediate the findings of an independent validation. The discussion below describes the proposed amendments in the order they appear in each policy.

i. CDS Back-Testing Policy

The proposed rule change first would correct the capitalization of the title of Section 2.1. In that section, the proposed rule change also would correct a typographical error by replacing the word “follow” with “follows.” In addition to those typographical corrections, the proposed rule change would add new language at the end of the section. This new language would explain that ICE Clear Europe conducts several types of backtests and that ICE Clear Europe adopts all the available reliable and validated data for each backtest in order to assess the model performance over a long period, where stress market conditions and idiosyncratic events are likely to have manifested.

Next, the proposed rule change would add a new Section 2.2 and re-number the remaining sections accordingly. New Section 2.2 would explain that ICE Clear Europe backtests the CDS risk model with overlapping data and non-overlapping data. This section also would explain that ICE Clear Europe prefers to backtest with non-overlapping data for static portfolios. Because the CDS risk model covers a multi-days risk horizon, the lack of sufficiently long data sets limits ICE Clear Europe’s ability to use non-overlapping data, however. ICE Clear Europe would address this limitation by using overlapping data to make a statistically significant sample.

This new Section 2.2, as well as the new language at the end of Section 2.1, would document ICE Clear Europe’s existing practice of backtesting using overlapping data and non-overlapping data, and, in doing so, using all the available reliable and validated data for each backtest in order to assess the model performance over a long period. Backtesting using

overlapping data potentially double-counts exceedances if the exceedances occur when data overlap. Because of this possible double-counting, backtesting with non-overlapping data is the preferred approach, but ICE Clear Europe still conducts backtesting with overlapping data, using all available reliable and validated data, to ensure it has an appropriate sample size.

The proposed rule change next would amend re-numbered Section 2.4 (currently Section 2.2), which describes the Basel Traffic Light System (“BTLS”).⁴ The proposed rule change would explain how ICE Clear Europe addresses one of the main assumptions of the BTLS, which is that excessive losses are time independent. As described above, ICE Clear Europe relies on overlapping data as necessary to ensure sufficiently long backtesting data sets. Conducting backtests with overlapping data could double-count exceedances if the exceedances occur when the data overlap. Because the BTLS assumes that exceedances are time independent, however, ICE Clear Europe corrects the number of consecutive exceedances within the risk time horizon.

The proposed rule change would re-number current Section 2.3 to Section 3.1, and add a title for a new Section 3 immediately before re-numbered Section 3.1. The proposed rule change would change the title of re-numbered Section 3.1 to Multi-days horizon backtesting. Within re-numbered Section 3.1, the proposed rule change would make four clarifications. First, the proposed rule change would specify that the observed loss is the minimum net asset value change over 5 days for house accounts, as distinct from 7 days for client accounts. Second, the proposed rule change would specify that the difference between the maximum observed unrealized loss and the backtested component of initial margin is also known as the “back-test

⁴ For a general description of the BTLS, see BIS, revisions to market risk disclosure requirements, available at <https://www.bis.org/bcbs/publ/d484.htm>.

exceedances.” Third, the proposed rule change would clarify that the maximum observed unrealized loss is also known as the “worst N-days P&L.”⁵ Finally, the proposed rule change would explain that ICE Clear Europe’s use of the worst N-days P&L may lead to multiple consecutive backtest exceedances following one large market move in the overlapping backtesting approach.

Next, the proposed rule change would correct the capitalization of the title of Section 3.2 (re-numbered from Section 2.4). In that section the proposed rule change also would explain that the last two examples in Table 2 could be the 4-days P/L or 3-days P/L.⁶

In Section 3.3 (re-numbered from Section 2.5), the proposed rule change would clarify that a minimum of one year of observations is required to define the statistical significance of backtesting results.

The proposed rule change would correct the capitalization of the title of Section 3.4 (re-numbered from Section 2.6). In that section the proposed rule change also would describe how ICE Clear Europe backtests special strategy portfolios. ICE Clear Europe backtests special strategy portfolios that cover certain trading strategies, such as Index arbitrage. The proposed rule change also would specify that the Clearing Risk Department reviews backtest results at the 99.5% quantile monthly, while backtest results at the 99.75% quantile would be reviewed on an

⁵ The proposed rule change would make similar updates to these terms throughout the CDS Back-Testing Policy.

⁶ ICE Clear Europe calculates daily back-testing results for each Clearing Member’s account for each of the 5 business days beginning 10 business days prior to the reporting date for house accounts (or 7 business days beginning 14 business days prior to the reporting period for client accounts). For each backtested day, ICE Clear Europe calculates the maximum observed unrealized loss with positions from the relevant Clearing Member’s accounts as of that day. Table 2 shows an example of this reporting.

ad-hoc basis, when there is a large market move. Finally, the proposed rule change would delete a table showing portfolio construction for special strategy backtesting because it is unnecessary in light of the new detail added to Section 3.4.

The proposed rule change would correct the capitalization of the title of Section 3.5 (re-numbered from Section 2.7).

The proposed rule would add a new section numbered 3.6 to explain how ICE Clear Europe backtests stylized portfolios. Stylized portfolios are portfolios that replicate certain trading strategies. This new section would explain that the Clearing Risk Department backtests a series of stylized portfolios when ICE Clear Europe clears a new risk factor.⁷ ICE Clear Europe backtests these portfolios, which replicate trading strategies, to assess the CDS risk model's treatment of the new risk factors. ICE Clear Europe also backtests risk factors that have the largest open interest. ICE Clear Europe represents that these changes reflect current backtesting practice and are intended to more clearly document such practices in the CDS Back-Testing Policy.⁸

The proposed rule change would correct the capitalization of the title of Section 3.7 (re-numbered from Section 2.8).

⁷ As explained in ICE Clear Europe's CDS Risk Model Description, the term risk factor refers to a CDS index, sub-index, or single-name. See Self-Regulatory Organizations; ICE Clear Europe Limited; Order Approving Proposed Rule Change Relating to the ICE Clear Europe CDS Clearing Stress Testing Policy, CDS End of Day Price Discovery Policy, CDS Risk Model Description and CDS Risk Policy and CDS Parameters Review Procedures, Exchange Act Release No. 91586 (Apr. 16, 2021); 86 Fed. Reg. 21418 (Apr. 22, 2021) (SR-ICEEU-2021-006).

⁸ Notice, 87 Fed. Reg. at 10879.

Finally, the proposed rule change would amend Section 4 (re-numbered from Section 3). Section 4 would describe ICE Clear Europe's univariate backtesting. The proposed rule change would clarify that the Clearing Risk Department reviews backtest results at the 99.5% quantile monthly and reports these results to the Model Oversight Committee monthly. Backtest results at the 99.75% quantile would be reviewed ad-hoc, when stress market conditions might cause breaches at the 99.5% quantile.

ii. CDS Stress-Testing Policy

The proposed rule change would make one change to the CDS Stress-Testing Policy. In Section 4.1.2 the proposed rule change would add the words "and hypothetical" to a paragraph describing forward-looking credit events scenarios. The change would clarify that the described forward-looking credit events scenarios are based on both historically observed and hypothetical extreme but plausible market scenarios. ICE Clear Europe represents that this change reflects current stress-testing practice.⁹

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.¹⁰ For the reasons discussed below, the Commission finds that the proposed rule

⁹ Notice, 87 Fed. Reg. at 10880.

¹⁰ 15 U.S.C. 78s(b)(2)(C).

change is consistent with Section 17A(b)(3)(F) of the Act,¹¹ and Rules 17Ad-22(e)(4)(vi)(A) and 17Ad-22(e)(6)(vi)(A) thereunder.¹²

i. 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.¹³ Based on its review of the record, and for the reasons discussed below, the Commission believes the proposed changes to the CDS Back-Testing Policy and CDS Stress-Testing Policy are consistent with the promotion of the prompt and accurate clearance and settlement of securities transactions.

The Commission believes that the proposed rule change would make the CDS Back-Testing Policy and CDS Stress-Testing Policy easier to use and apply. One way it would do so is by explaining ICE Clear Europe's backtesting and stress testing practices. These practices would include: a preference for backtesting using non-overlapping data; corrections to exceedances in overlapping data to conform to the assumption from the BTLS that losses are time-independent; the requirement of a minimum of one year of observations to define the statistical significance of backtesting results; use of all available reliable and validated data for each backtest; and, with respect to the CDS Stress-Testing Policy, that forward-looking credit event scenarios are based on both historically observed and hypothetical extreme but plausible market scenarios. The

¹¹ 15 U.S.C. 78q-1(b)(3)(F).

¹² 17 CFR 240.17Ad-22(e)(4)(vi)(A) and 17 CFR 240.17Ad-22(e)(6)(vi)(A).

¹³ 15 U.S.C. 78q-1(b)(3)(F).

Commission believes that documenting these practices in ICE Clear Europe's policies should facilitate more consistent and predictable backtesting and stress testing.

Another way the proposed rule change would make the CDS Back-Testing Policy easier to use and apply is by explaining how ICE Clear Europe backtests special strategy portfolios. The proposed rule change would describe the set of portfolios used in backtesting of special strategy portfolios, and also would explain how ICE Clear Europe reviews and reports results at 99.5% quantiles and 99.75% quantiles for special strategy portfolios and univariate backtesting. The proposed rule change also would explain how ICE Clear Europe backtests stylized portfolios when it clears a new risk factor. The Commission believes that documenting such additional explanations would help to clarify how ICE Clear Europe backtests portfolios that use special trading strategies and reports the results of those backtests.

The proposed rule change also would make the CDS Back-Testing Policy easier to use and apply by clarifying certain terminology used in the policy and by correcting typographical errors. For example, the proposed rule change would clarify that the shortfall between the maximum observed unrealized loss and the backtested component of initial margin is also known as "back-test exceedances" and that the maximum observed unrealized loss is also known as "worst N-days P&L." The proposed rule also would clarify that the observed loss is calculated as the minimum net asset value change over 5 days for house accounts as distinct from 7 days for client accounts, and that the last two examples in Table 2 could be the 4-days P/L or 3-days P/L. In addition to these clarifications, the proposed rule change would correct typographical errors and re-number sections. The Commission believes these particular changes would help to increase the clarity and accuracy of the CDS Back-Testing Policy.

Because ICE Clear Europe backtests and stress tests the CDS risk model using the CDS Back-Testing Policy and CDS Stress-Testing Policy, the Commission believes that these improvements to the policies would improve ICE Clear Europe's backtesting and stress testing. Improved backtesting and stress testing should help ICE Clear Europe to find deficiencies in, and correct, the CDS risk model. Better risk models should, in turn, increase the likelihood that ICE Clear Europe will have sufficient financial resources in excess of margin to address losses that could arise from the default of a Clearing Member. The Commission believes that by increasing the likelihood that ICE Clear Europe will have sufficient financial resources, the proposed rule change would enhance ICE Clear Europe's ability to continue to promptly and accurately clear and settle securities transactions during periods of market stress, consistent with Section 17A(b)(3)(F) of the Act.¹⁴

Therefore, the Commission finds that the proposed rule change is consistent with Section 17A(b)(3)(F) of the Act.¹⁵

ii. Consistency with Rule 17Ad-22(e)(4)(vi)(A) under the Act

Rule 17Ad-22(e)(4)(vi)(A) requires that ICE Clear Europe 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 testing the sufficiency of its total financial resources available to meet the minimum financial resource requirements under Rule 17Ad-

¹⁴ 15 U.S.C. 78q-1(b)(3)(F).

¹⁵ 15 U.S.C. 78q-1(b)(3)(F).

22(e)(4)(i) through (iii),¹⁶ as applicable, by conducting stress testing of its total financial resources once each day using standard predetermined parameters and assumptions.¹⁷ As discussed above, the Commission believes the proposed rule change should improve ICE Clear Europe’s CDS Stress-Testing Policy by clarifying that the forward-looking credit events scenarios are based on both historically observed and hypothetical extreme but plausible market scenarios. Because ICE Clear Europe uses the CDS Stress-Testing Policy and the forward-looking credit event scenarios to conduct daily stress testing of its total financial resources, the Commission believes this aspect of the proposed rule change should help to ensure that ICE Clear Europe conducts stress testing of its total financial resources once each day using standard predetermined parameters and assumptions, including forward-looking credit event scenarios that are based on both historically observed and hypothetical extreme but plausible market scenarios.¹⁸

Therefore, the Commission finds that this aspect of the proposed rule change is consistent with Rule 17Ad-22(e)(4)(vi)(A).¹⁹

¹⁶ 17 CFR 240.17Ad-22(e)(4)(i)-(iii).

¹⁷ 17 CFR 240.17Ad-22(e)(4)(vi)(A).

¹⁸ The CDS Stress-Testing Policy requires that ICE Clear Europe conduct stress testing daily. See Self-Regulatory Organizations; ICE Clear Europe Limited; Order Approving Proposed Rule Change Relating to Amendments to the ICE Clear Europe CDS Risk Policy (the “CDS Risk Policy”), CDS Clearing Back-Testing Policy (the “Back-Testing Policy”) and CDS Stress-Testing Policy (the “Stress-Testing Policy”) (Collectively, the “CDS Policies”), Exchange Act Release No. 85236 (Mar. 1, 2019); 84 Fed. Reg. 8348 (Mar. 7, 2019) (SR-ICEEU-2018-010).

¹⁹ 17 CFR 240.17Ad-22(e)(4)(vi)(A).

iii. Consistency with Rule 17Ad-22(e)(6)(vi)(A) under the Act

Rule 17Ad-22(e)(6)(vi)(A) requires that ICE Clear Europe 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, is monitored by management on an ongoing basis and is regularly reviewed, tested, and verified by conducting backtests of its margin model at least once each day using standard predetermined parameters and assumptions.²⁰ As discussed above, the Commission believes the changes to the CDS Back-Testing Policy would overall make the policy easier to use and apply. Because ICE Clear Europe uses the CDS Back-Testing Policy to conduct daily backtests of its margin model, the Commission believes these aspects of the proposed rule change should help to ensure that ICE Clear Europe conducts backtests of its margin model at least once each day using standard predetermined parameters and assumptions.²¹ Therefore, the Commission finds that this aspect of the proposed rule change is consistent with Rule 17Ad-22(e)(6)(vi)(A).²²

²⁰ 17 CFR 240.17Ad-22(e)(6)(vi)(A).

²¹ The CDS Back-Testing Policy requires that ICE Clear Europe conduct back-testing daily. See Self-Regulatory Organizations; ICE Clear Europe Limited; Order Approving Proposed Rule Change Relating to Amendments to the ICE Clear Europe CDS Risk Policy (the “CDS Risk Policy”), CDS Clearing Back-Testing Policy (the “Back-Testing Policy”) and CDS Stress-Testing Policy (the “Stress-Testing Policy”) (Collectively, the “CDS Policies”), Exchange Act Release No. 85236 (Mar. 1, 2019); 84 Fed. Reg. 8348 (Mar. 7, 2019) (SR-ICEEU-2018-010).

²² 17 CFR 240.17Ad-22(e)(6)(vi)(A).

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,²³ and Rules 17Ad-22(e)(4)(vi)(A) and 17Ad-22(e)(6)(vi)(A) thereunder.²⁴

IT IS THEREFORE ORDERED pursuant to Section 19(b)(2) of the Act²⁵ that the proposed rule change (SR-ICEEU-2022-004) be, and hereby is, approved.²⁶

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²⁷

J. Matthew DeLesDernier
Assistant Secretary

²³ 15 U.S.C. 78q-1(b)(3)(F).

²⁴ 17 CFR 240.17Ad-22(e)(4)(vi)(A) and 17 CFR 240.17Ad-22(e)(6)(vi)(A).

²⁵ 15 U.S.C. 78s(b)(2).

²⁶ 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).

²⁷ 17 CFR 200.30-3(a)(12).