

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-87360 ; File No. SR-ICEEU-2019-017]

### Self-Regulatory Organizations; ICE Clear Europe Limited; Order Approving Proposed Rule Change, as Modified by Partial Amendment No. 1, Relating to Amendments to the ICE Clear Europe CDS Clearing Back-Testing Policy

October 18, 2019.

#### I. Introduction

On August 19, 2019, 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”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to revise its CDS Clearing Back-Testing Policy (“Back-Testing Policy”). On August 27, 2019, ICE Clear Europe filed Partial Amendment No. 1 to the proposed rule change.<sup>3</sup> The proposed rule change was published for comment in the **Federal Register** on September 4, 2019.<sup>4</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, as modified by Partial Amendment No. 1 (hereafter referred to as the “proposed rule change”).

#### II. Description of the Proposed Rule Change

The proposed rule change would amend the Back-Testing Policy to update the description of ICE Clear Europe’s back-testing process, including the level at which ICE Clear Europe performs back-testing, and the back-testing of ICE Clear Europe’s special strategy portfolios and Monte Carlo (“MC”) model.<sup>5</sup> The proposed rule change would also update the reporting requirements of back-testing results, including the frequency of reporting of exceedance summaries. Finally, the proposed rule change would make

technical corrections and updates to the Back-Testing Policy.

##### A. Back-Testing Process

The proposed rule change would amend the Back-Testing Policy to state that ICE Clear Europe performs back-testing at the Clearing Member account level, rather than at the portfolio level, on a daily basis. The proposed rule change would move the section on Detailed Daily Portfolio Back-Testing Results from section 3.4 into a new section numbered 3.1 and update the description in that section to reflect back-testing at the Clearing Member account level. This proposed change is intended to make the description of ICE Clear Europe’s back-testing more precise and consistent with ICE Clear Europe’s current practice.

The proposed rule change would also update the description of ICE Clear Europe’s performance of back-testing using special strategy portfolios. As explained in the Back-Testing Policy, ICE Clear Europe performs daily back-testing for the model using a specific set of special strategy portfolios at 99.5% and 99.75% quantiles. The proposed rule change would add to this set of special strategy portfolios an additional strategy, iTraxx Senior Financial 5Y.OTR Arb. This new strategy would be constructed in the same manner as the existing strategies but would relate only to the iTraxx Senior Financials 5Y index. Because ICE Clear Europe regularly back tests using this strategy, ICE Clear Europe is adding this strategy to the Back-Testing Policy to reflect its current practice.

The proposed rule change would also amend the description of the other special strategies to better reflect ICE Clear Europe’s practices in employing the special strategies. For example, the proposed rule change would update the names of the special strategies; change the use of the terms “short” and “long” to “bought” and “sold”; and specify that, for the sake of completeness, ICE Clear Europe also considers the opposite strategy when back-testing a special strategy (e.g., for one sold protection position in the on-the-run iTraxx Europe Main 5Y index, the opposite strategy would be one bought protection position in each of the single name constituents of the index, weighted by notional).

The proposed rule change would amend the description of the back-testing of ICE Clear Europe’s MC model to make a number of clarifications. This amendment is intended only to clarify what is meant in the policy by “Monte Carlo back-testing”, which is back-testing only the MC model and not the

stress-based model. There would be no change to the current practice with respect to MC model back testing. First, the proposed rule change would clarify that back-tests are performed daily on the Spread Response component of the Initial Margin using ICE Clear Europe’s MC model and is specific to that model, rather than the combined Spread Response approach which uses the worst loss estimated between either the scenario-based approach or the Monte Carlo approach. Second, the proposed rule change would clarify that ICE Clear Europe performs the MC back-test on individual Clearing Member accounts using the risk approach for the Spread Response Initial Margin, rather than at the portfolio level. As part of this change, the proposed rule change would remove specific references to the risk quantiles. Third, the proposed rule change would clarify that the back-tested risk measure includes the sum of the following quantities: MC value-at-risk, interest rate, recovery rate, and basis risk. The current Back-Testing Policy does not include a specific reference to “basis risk”, but rather to the “portfolio” quantity. This would clarify that the basis risk initial margin component is part of the back-tested initial margin components. Fourth, the proposed rule change would remove an unnecessary distinction depending on whether the indices are decomposed, which is not applicable using the MC approach. In ICE Clear Europe’s view, these changes would improve the readability of the policy and better reflect current ICE Clear Europe practices, but would not alter such practices.

ICE Clear Europe represents that these changes, as a whole, clarify that, with respect to MC back-testing, ICE Clear Europe is back-testing only the MC model and not the stress-based model.

##### B. Reporting

With respect to reporting of back-testing results, the proposed rule change would require that the Clearing Risk department report the CDS back testing results and analysis to the CDS Product Risk Committee and the Model Oversight Committee on a monthly basis. Currently, the Back-Testing Policy only requires reporting to the CDS Product Risk Committee (on a monthly basis). Similarly, the proposed rule change would require that the Clearing Risk department provide an exceedance summary to the CDS Product Risk Committee and the Model Oversight Committee monthly, while currently the Back-Testing Policy only requires that the Clearing Risk department provide an exceedance summary to the CDS

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

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

<sup>3</sup> Partial Amendment No. 1 corrected an inaccurate statement in the initial proposed rule change but did not make any changes to the substance of the filing or the text of the proposed rule change.

<sup>4</sup> Securities Exchange Act Release No. 34-86782 (August 28, 2019), 84 FR 46573 (September 4, 2019) (SR-ICEEU-2019-017) (“Notice”).

<sup>5</sup> This description is substantially excerpted from the Notice, 84 FR at 46573. Capitalized terms not otherwise defined have the meanings assigned to them in the Back-Testing Policy or ICE Clear Europe rulebook.

Product Risk Committee. Finally, the proposed rule change would clarify that the Clearing Risk Department reviews back-testing results on a daily basis, consistent with current practice.

With respect to the Basel Traffic Light System (“BTLs”) Exceedance Summaries, the proposed rule change would move the description of the exceedance summary from Section [\*\*] into new Section 3.2, which is labeled Back-Testing the Production Model with Clearing Members Accounts. Additionally, in Section 3.5, the proposed rule change would clarify that BTLs Exceedance Summaries are provided for back-testing at the Clearing Member account level, as discussed above. The proposed rule change also would revise the frequency of reporting to state that, at least monthly, BTLs Exceedance Summaries are reported using the production model for each Clearing Member’s account, special-strategies, and the MC model. Currently the CDS Clearing Back-Testing Policy specifies that BTLs Exceedance Summaries are reported [insert current frequency]. ICE Clear Europe represents that this would align the frequency of the reporting to the relevant regulatory requirement under Commission Rule 17Ad-22(b)(2).

### C. Technical Amendments

The proposed rule change would remove specific references to testing quantiles of 99% and 99.25%, because ICE Clear Europe no longer tests at those specific quantiles given that they are lower than the minimum 99.5% quantile used by ICE Clear Europe and prescribed by the European Market Infrastructure Regulation.

Finally, the proposed rule change would correct typographical errors and update defined terms and references as needed.

### 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 such proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to such organization.<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)(i) and (v), and (e)(6)(vi) 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, as well as 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 in detail below, the Commission believes that the changes described above, taken as a whole, would help to improve ICE Clear Europe’s back-testing, which in turn would help improve ICE Clear Europe’s ability to avoid losses that could disrupt ICE Clear Europe’s ability to promptly and accurately clear security based swap transactions, and therefore would help promote the prompt and accurate clearance and settlement of securities transactions.

First, in providing that ICE Clear Europe conducts back-testing at the Clearing Member account level, rather than at the portfolio level, the Commission believes that the proposed rule change would help to improve ICE Clear Europe’s back-testing by making the description of ICE Clear Europe’s process more precise and ensuring that the description is consistent with ICE Clear Europe’s current practice. Moreover, by adding a new special strategy portfolio for iTraxx Senior Financial 5Y.OTR Arb, the Commission believes that the proposed rule change would help ensure that ICE Clear Europe back-tests using this strategy, which could offer ICE Clear Europe additional insight and data by providing a new strategy to test. Similarly, the Commission believes that the proposed rule change, in amending the description of the other strategies to better reflect ICE Clear Europe’s practices in employing the strategies, would help to ensure that ICE Clear Europe’s back-testing of the special strategies is consistent with ICE Clear Europe’s current practices and uniform among different back-tests. In making the changes described above to the MC back-testing, to clarify that ICE Clear Europe is back-testing only the MC model and not the stress based model, the Commission similarly believes that the proposed rule change would help to ensure that ICE Clear Europe’s back-

testing of the MC Model is consistent with ICE Clear Europe’s current practices and uniform among different back-tests. Finally, in removing references to testing quantiles that ICE Clear Europe no longer employs, and correcting typographical errors and updating defined terms and references, the Commission believes that the proposed rule change would eliminate unnecessary terms and errors in the Back-Testing Policy which could lead to erroneous application of ICE Clear Europe’s back-testing process. The Commission believes that all of these changes, taken as a whole, would help to improve the quality of ICE Clear Europe’s back-testing.

Moreover, the Commission believes that the changes described above with respect to reporting of back-testing results would help improve ICE Clear Europe’s use of the information generated by back-testing. Specifically, in requiring that the Clearing Risk Department report back-testing results and an exceedance summary to the Model Oversight Committee, in addition to the Product Risk Committee, the Commission believes that the proposed rule change would help to ensure that the Model Oversight Committee has back-testing information which it could use to help improve ICE Clear Europe’s margin model. Similarly, in requiring that the Clearing Risk Department review back-testing results on a daily basis, the Commission believes that the proposed rule change would help to ensure that any deficiencies or problems revealed by back-testing are taken into consideration without delay. Finally, in amending the reporting of the BTLs Exceedance Summaries, the Commission believes that the proposed rule change would help to provide a better representation of the results of back-testing against the BTLs.

Finally, because back-testing can help reveal inadequacies in ICE Clear Europe’s margin requirements and the models that support those requirements, the Commission believes that the proposed rule change would help to ensure that ICE Clear Europe maintains effective margin requirements. Given that an effective margin system is necessary to manage ICE Clear Europe’s credit exposures to its Clearing Members and the risks associated with clearing security based swap-related portfolios, the Commission believes that the proposed rule change would help improve ICE Clear Europe’s ability to avoid losses that could result from the mismanagement of such credit exposures and risks. Because such losses could disrupt ICE Clear Europe’s ability to promptly and accurately clear

<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)(i) and (v), and (e)(6)(vi).

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

security based swap transactions, by making the above-described improvements to ICE Clear Europe's back-testing, the Commission believes that the proposed rule change would help promote the prompt and accurate clearance and settlement of securities transactions. Similarly, given that such losses could threaten ICE Clear Europe's access to securities and funds in ICE Clear Europe's control, by making the above-described improvements to ICE Clear Europe's back-testing, the Commission believes that the proposed rule change would help assure the safeguarding of securities and funds which are in the custody or control of ICE Clear Europe or for which it is responsible. Finally, for both of these reasons, the Commission believes the proposed rule change is consistent with protecting investors and the public interest.

Therefore, the Commission finds that the proposed rule change would promote the prompt and accurate clearance and settlement of securities transactions, assure the safeguarding of securities and funds in ICE Clear Europe's custody and control, and, in general, protect investors and the public interest, consistent with the Section 17A(b)(3)(F) of the Act.<sup>10</sup>

#### *B. Consistency With Rules 17Ad-22(e)(2)(i) and (v)*

Rules 17Ad-22(e)(2)(i) and (v) require 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 specify clear and direct lines of responsibility.<sup>11</sup>

As discussed above, the proposed rule change would revise the Back-Testing Policy by requiring that the Clearing Risk department report the CDS back-testing results and analysis and provide an exceedance summary to the Model Oversight Committee as well as to the CDS Product Risk Committee. The Commission believes that this change would improve the transparency of ICE Clear Europe's governance arrangements by clarifying the role played by the Model Oversight Committee in reviewing the results of back-testing. Similarly, in requiring that the Clearing Risk Department review back-testing results on a daily basis, the Commission believes that the proposed rule change would help clearly define the responsibility of the Clearing Risk Department in reviewing the results of back-testing.

Therefore, for the above reasons the Commission finds that the proposed rule change is consistent with Rules 17Ad-22(e)(2)(i) and (v).<sup>12</sup>

#### *C. Consistency With Rule 17Ad-22(e)(6)(vi)*

Rule 17Ad-22(e)(6)(vi) 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, among other things, conducting back-tests of its margin model at least once each day using standard predetermined parameters and assumptions.<sup>13</sup>

As discussed above, the proposed rule change would amend the Back-Testing Policy to state that ICE Clear Europe performs back-testing at the Clearing Member account level on a daily basis. The proposed rule change also would require that the Clearing Risk Department review back-testing results on a daily basis. The Commission believes that both of these changes would ensure that ICE Clear Europe conducts back-testing at least once each day.

Therefore, for the above reasons the Commission finds that the proposed rule change is consistent with Rule 17Ad-22(e)(6)(vi).<sup>14</sup>

#### **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>15</sup> and Rules 17Ad-22(e)(2)(i) and (v), and (e)(6)(vi) thereunder.<sup>16</sup>

*It is therefore ordered* pursuant to Section 19(b)(2) of the Act<sup>17</sup> that the proposed rule change (SR-ICEEU-2019-017) be, and hereby is, approved.<sup>18</sup>

<sup>12</sup> *Id.*

<sup>13</sup> 17 CFR 240.17Ad-22(e)(6)(vi).

<sup>14</sup> *Id.*

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

<sup>16</sup> 17 CFR 240.17Ad-22(e)(2)(i) and (v), and (e)(6)(vi).

<sup>17</sup> 15 U.S.C. 78s(b)(2).

<sup>18</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).

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>19</sup>

**Eduardo A. Aleman,**  
*Deputy Secretary.*

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## **SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-87342; File No. SR-C2-2019-022]

### **Self-Regulatory Organizations; Cboe C2 Exchange, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change To Extend the Pilot Period Related to the Market-Wide Circuit Breaker in Rule 6.32.01**

October 18, 2019.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the "Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on October 16, 2019, Cboe C2 Exchange, Inc. (the "Exchange" or "C2") filed with the Securities and Exchange Commission (the "Commission") the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. The Exchange filed the proposal as a "non-controversial" proposed rule change pursuant to Section 19(b)(3)(A)(iii) of the Act<sup>3</sup> and Rule 19b-4(f)(6) thereunder.<sup>4</sup> The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

#### **I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change**

Cboe C2 Exchange, Inc. (the "Exchange" or "C2") proposes to extend the pilot period related to the market-wide circuit breaker in Rule 6.32.01. The text of the proposed rule change is provided in Exhibit 5.

The text of the proposed rule change is also available on the Exchange's website ([http://markets.cboe.com/us/options/regulation/rule\\_filings/ctwo/](http://markets.cboe.com/us/options/regulation/rule_filings/ctwo/)), at the Exchange's Office of the Secretary, and at the Commission's Public Reference Room.

#### **II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change**

In its filing with the Commission, the Exchange included statements

<sup>19</sup> 17 CFR 200.30-3(a)(12).

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

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

<sup>3</sup> 15 U.S.C. 78s(b)(3)(A)(iii).

<sup>4</sup> 17 CFR 240.19b-4(f)(6).

<sup>10</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>11</sup> 17 CFR 240.17Ad-22(e)(2)(i) and (v).