

Maria Zyskind
Staff Attorney

July 15, 2019

**Re: ICE Clear Credit LLC Advance Notice of
Proposed Rule Change Pursuant to
Commission Regulation 40.10**

VIA ELECTRONIC PORTAL

Mr. Christopher Kirkpatrick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, D.C. 20581

Dear Mr. Kirkpatrick:

ICE Clear Credit LLC (“ICC”), a registered derivatives clearing organization (“DCO”) under the Commodity Exchange Act, as amended (the “Act”), that has been designated by the Financial Stability Oversight Council as systemically important under Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, hereby submits to the Commodity Futures Trading Commission (the “Commission”), pursuant to Commission Regulation 40.10 as an advance notice of a proposed rule change, the amendments to its Clearing Rules (the “Rules”)¹ and related procedures to provide for the clearing of credit default index swaptions.

ICC proposes amendments to its Rules, End-of-Day Price Discovery Policies and Procedures (the “EOD Policy”) and Risk Management Framework (the “Risk Framework”) to provide for the clearing by ICC of credit default index swaptions (“Index Swaptions”). This submission includes a description of the changes to the Rules, EOD Policy, and Risk Framework. Certification of the changes pursuant to Section 5c(c)(1) of the Act and Commission Regulation 40.10 is also provided below.

The purpose of the proposed changes is to provide for the clearing of Index Swaptions. Pursuant to an Index Swaption, 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.

ICC is proposing to adopt a new Subchapter 26R of its Rules, which will set out the contract terms and specifications for cleared Index Swaptions. ICC is also proposing to adopt amendments to its EOD Policy which would establish an end-of-day (“EOD”) settlement price submission process for Index Swaptions. Proposed amendments to the Risk Framework would address the margining and risk management processes for Index Swaptions, among other matters. The text of the proposed amendments is attached hereto.

Prior to the commencement of clearing of Index Swaptions, ICC intends to adopt certain other policies and procedures, including a new set of Exercise Procedures, which will address in further detail the manner in which Index Swaptions may be exercised by Swaption Buyers and the manner in which ICC

¹ Capitalized terms used but not defined herein have the meanings specified in the Rules.

will assign such exercises to Swaption Sellers. ICC also expects to make certain changes to its Risk Management Model Description relating to the initial margin model for Index Swaptions. ICC will make subsequent filings pursuant to Commission regulation with respect to such additional or amended policies or procedures as required. ICC does not intend to commence clearing of Index Swaptions until ICC is permitted under Commission regulation to implement the changes described in all such filings, as well as the current filing (“Index Swaptions Related Filings”). As such, ICC proposes to implement the changes to the Rules, EOD Policy, and Risk Framework only after ICC is permitted under Commission regulation to implement the changes described in all Index Swaptions Related Filings and ICC completes its governance process surrounding the Index Swaptions product expansion.

Rule Amendments

In new Subchapter 26R, Rule 26R-102 will set out key definitions used for Index Swaptions, which are generally similar to those used in the subchapters for other index Contracts cleared by ICC. Key defined terms would include “Eligible Untranching Swaption Index”, which would specify the applicable series and version of a CDX or iTraxx index or sub-index underlying an Index Swaption. As with other index Contracts, ICC would maintain a List of Eligible Untranching Swaption Indices, which will contain the Eligible Untranching Swaption Indices as well as the eligible expiration dates and strike prices, as well as other relevant terms, for Index Swaptions that will be accepted for clearing by ICC. The rule would define the “Relevant Index Swaption Untranching Terms Supplement”, which is the market-standard published standard terms document for index swaptions of the relevant type that would be incorporated by reference into the contract terms in the Rules for a cleared Index Swaption. The rule also would define the “Underlying Contract,” which would be the index CDS Contract into which the Index Swaption may be exercised, and the “Underlying New Trade,” which would be a new single name CDS trade that would arise upon exercise of an Index Swaption where a relevant Restructuring Credit Event, if applicable, has occurred with respect to a reference entity in the relevant index.

New Rule 26R-103 would clarify the application of certain aspects of the Rules to Index Swaptions. For most purposes of the Rules, including Chapters 20 (regarding default management), 20A (regarding transfers of positions), 21 (regarding determination of credit events) and 26E (regarding restructuring credit events), Index Swaptions would be treated as CDS Contracts. Although Index Swaptions are “physically settled,” as that term is understood in the market for swaptions (meaning that the swaption, upon exercise, will result in the parties entering into an index credit default swap position on the specified terms), the physical settlement terms for CDS Contracts in Chapter 22 of the Rules would not apply to settlement of the Index Swaption itself. Once an Index Swaption has been exercised, the resulting Underlying Contract and Underlying New Trade, if any, would themselves be treated as CDS Contracts for all purposes of the Rules.

In Rule 26R-309, CDS Participants agree to use reasonable efforts not to submit for clearing an Index Swaption at a time when the Underlying Contract could not be submitted for clearing under the Rules or at a time when the CDS Participant would be under an obligation to use reasonable efforts not to submit such Underlying Contract. (The Rules related to CDS Contracts cleared by ICC impose limitations on submission of trades for clearing at certain times.)² As with other CDS Contracts under the Rules, a CDS Participant would also be required to notify ICC if it has submitted an Index Swaption that was not a Conforming Trade under the Rules.

Rule 26R-315 would establish certain basic terms for Index Swaptions. The Rule would provide that the Index Swaption is governed by the Relevant Index Swaption Untranching Terms Supplement (which contains the market standard terms for uncleared Index Swaptions of the relevant type), subject to the relevant provisions of Subchapter 26R of the Rules (which would govern in the case of any inconsistency). The approach is consistent with the treatment of other cleared index CDS Contracts under the Rules, which rely on and incorporate their own forms of standard terms supplements.

Rule 26R-316 would address the situation where a new Index Swaption Untranching Terms Supplement is published. Consistent with ICC’s practice for other index CDS Contracts, the ICC Board or its designee

² See, e.g., ICC Rule 26A-309.

would determine whether Index Swaptions referencing the existing standard terms supplement would be fungible with Index Swaptions referencing the new standard terms supplement, and if so, ICC would update existing Index Swaptions to reference the new standard terms supplement.

Rule 26R-317 specifies other key terms for Index Swaptions. Subsection (a) addresses certain modifications to the Relevant Index Swaption Standard Terms Supplement and the 2014 Definitions incorporated therein, in the context of an Index Swaption referencing a CDX.NA index. These generally reflect changes necessary to accommodate the clearing of the Index Swaption transactions, including to incorporate the clearing house's procedures for determination of a Credit Event and for application of physical settlement, and are consistent with similar modifications used for the Underlying Contract itself under the applicable subchapter of Chapter 26 of the Rules. Subsection (b) makes similar modifications in the case of an Index Swaption referencing an iTraxx Europe index. Rule 26R-317(c) states explicitly that Index Swaptions will be physically settled in accordance with Subchapter 26R (and not, for the avoidance of doubt, the physical settlement rules in Chapter 22 (which may apply to the settlement of the Underlying Contract, if applicable, but not to the settlement of the Index Swaption)).

Rule 26-317(d) sets out certain terms and elections under the Relevant Index Swaption Untranching Terms Supplement that will apply to all Index Swaptions of a particular type and underlying index. Significantly, ICC will only accept Index Swaptions that are European style, such that the option may only be exercised on the expiration date. ICC is defined as the Calculation Agent, except as provided in the CDS Committee Rules in Chapter 21. The rule would also set out certain elections regarding the Underlying Contract.

Rule 26-317(e) would set out the terms for an Index Swaption that must be included in the submission of a transaction for clearing, including identifying the underlying index, swaption trade date, expiration date, Swaption Buyer, Swaption Seller, strike price and swaption premium. The submission would also specify whether the Index Swaption is a "payer" or "call" option, in which case the Swaption Buyer, upon exercise, would be the fixed rate payer under the Underlying Contract, or a "receiver" or "put" option, in which case the Swaption Seller, upon exercise, would be the fixed rate payer under the Underlying Contract. The submission would also specify the scheduled termination date of the Underlying Contract and original notional amount of the Underlying Contract.

Procedures for exercise and assignment of Index Swaptions would be addressed in new Rule 26R-318. Specifically, an Open Position in an Index Swaption may be exercised on its expiration date by the relevant Participant (or, in the case of a client position, the relevant Non-Participant Party) that is the Swaption Buyer delivering an exercise notice to ICC.³ When ICC receives exercise notices in respect of a particular type of Index Swaption on its expiration date, ICC will assign the exercise notices to Open Positions of Participants that are Swaption Sellers (across both the house and customer origin accounts) in accordance with the Exercise Procedures. Such an assignment will constitute exercise by ICC of its Index Swaption position against such Swaption Sellers (and the exercise of the position between the exercising Swaption Buyer and ICC and an offsetting position between ICC and the assigned Swaption Seller will be deemed to occur simultaneously). The assignment of an exercise notice does not create a direct relationship between the exercising Swaption Buyer and the assigned Swaption Seller; both such parties continue to face ICC as clearing organization. Index Swaptions that are not validly exercised on the expiration date will expire without further obligation of any party.

New Rule 26R-319 would address procedures for settlement of an exercised Index Swaption. Upon exercise, a cleared Contract in the form of the Underlying Contract will automatically come into effect as between the exercising Swaption Buyer and ICC and an offsetting cleared Contract will automatically

³ ICC contemplates that it will adopt a set of Exercise Procedures that will provide further detail as to the manner in which Index Swaptions may be exercised by Swaption Buyers and in which notices of exercise will be assigned to Swaption Sellers. The Exercise Procedures may also detail any circumstances under which Index Swaptions would be automatically exercised at expiration. ICC expects that it will separately file such procedures with the Commission as required.

come into effect as between ICC and the assigned Swaption Seller. A settlement payment in connection with the exercise (representing a strike adjustment amount based on the strike price of the Index Swaption and an accrual amount (reflecting the accrued fixed payment for the Underlying Contract through expiration)) will be paid by one party to the other in accordance with the terms of the relevant Index Swaption (based on the Relevant Index Swaption Untranching Terms Supplement).

Consistent with the terms of the Index Swaption, additional settlements may be required under Rule 26R-319(b) if one or more Credit Events has occurred with respect to the underlying index at or prior to the expiration date of the Index Swaption. In general, such settlements are designed so that the party in the position of the protection buyer under the Index Swaption would receive settlement for all such Credit Events as if it had held the Underlying Contract at the time of the Credit Event. These settlement amounts may include auction cash settlement amounts, fixed rate payments, and accruals with respect to such credit events. The proposed rule would also provide for an additional accrual amount, owed by the party that is in the position of fixed rate payer or floating rate payer, as applicable, to ensure consistency in economic result where the swaption expiration occurs after the relevant auction date for a Credit Event as compared to cases where expiration occurs before the auction date. Rule 26R-319(b) also addresses cases where the relevant Underlying Contract is itself subject to physical settlement under Chapter 22 of the Rules, and provides for matching of Swaption Buyers and Swaption Sellers for that purpose. Rule 26R-319(c) would apply in the case of a relevant M(M)R Restructuring Credit Event, and provide for delivery of MP Notices (both Restructuring Credit Event Notices and Notices to Exercise Movement Option) by Swaption Buyer and Swaption Sellers prior to expiration of the Index Swaption, which will have effect with respect to the Underlying New Trade established if the Index Swaption is exercised. Subsection (c) also addresses settlement with respect to the Underlying New Trade.

Rule 26R-502 would clarify that certain actions do not constitute Specified Actions subject to Risk Committee consultation, including adding new eligible strike prices and expiration dates for Index Swaptions and adding new series and tenors for the Underlying Contracts for Index Swaptions. Consistent with similar provisions for other product subchapters, Rule 26R-616 would provide that actions to give effect to certain determinations of the Credit Derivatives Determinations Committee or Regional CDS Committee, such as succession events and the like, would not constitute a Contract Modification for purposes of the Rules.

EOD Policy Amendments

ICC also proposes to amend its EOD Policy to incorporate Index Swaptions. The EOD Policy sets out ICC's EOD price discovery process used to determine the daily settlement prices for all cleared Contracts, based on submissions made by Participants. The amended EOD Policy would specify the characteristics that define a unique Index Swaption instrument for purposes of price submissions, including exercise style, underlying index, option type (put or call), expiration date, strike price and convention (price or spread) and transaction type (reflecting the applicable legal documentation). The policy would further define a "put/call surface pair," as the group of Index Swaptions with the same combination of underlying index, strike convention and transaction type, but differ with respect to option type, expiration date and strike price, and a "surface," as the group of Index Swaptions from a given put/call surface pair with the same option type (such that for every put/call surface pair there is a put surface and a call surface). Under the policy, a "strip" would be referred to as the group of Index Swaptions on a given surface with the same expiration date (but with different strike prices).

The revised EOD Policy would establish a methodology for determining EOD bid-offer widths ("BOWs") for clearing-eligible Index Swaptions, which are used for establishing EOD settlement prices. Under the methodology, ICC uses the EOD BOW of the Underlying Contract in price terms for each put/call surface pair. For each strip, ICC would determine an around-at-the money BOW using the underlying index EOD BOW and scaling factors that take into account time to expiry and the magnitude of an at-the-money swaption's BOW as related of the BOW of the underlying. ICC then determines a systematic BOW for each Index Swaption on a strip by applying an in-the-moneyness scaling factor based on strike prices. The final BOW for an Index Swaption would be determined as the greater of the systematic BOW and a dynamic BOW determined on the range of a series of unique price submissions made by Participants for

the particular Index Swaption (excluding certain of the largest and smallest elements), in a manner similar to that currently used for calculating dynamic BOWs for single name instruments.

The EOD Policy also would set out price submission requirements for Participants. If a Participant has a gross notional position in any Index Swaption in any strip of puts or calls, the Participant must provide submissions for all clearing-eligible instruments in that strip of puts or calls and the corresponding strip of calls or puts. In addition, if an insufficient number of Participants are required to submit under this standard, ICC may require all Participants to provide relevant submissions. Under the amendments, ICC would establish a separate price submission window for Index Swaptions that differs from the current submission window for CDS Contracts. The policy would specify the required format of submissions, and permit either midpoint or bid-offer pair submissions. ICC will convert submissions into standardized bid-offer pairs using the calculated EOD BOW as discussed above. ICC would also determine implied forward prices for all underlying index instruments for which EOD Index Swaption prices are determined, for maturities corresponding to each Index Swaption expiration date.

ICC would apply its firm trade requirements, under which a subset of trades generated by ICC's cross-and lock algorithm are required to be entered into by Participants, to Index Swaptions. As with other cleared products, there would be a notional limit for firm Index Option trades for Participants affiliate groups. The amended policy would set out procedures for determining the relevant firm trade days for Index Swaptions and the strips of puts and calls that are firm-trade eligible. Firm trades in Index Swaptions may be eligible for reversing transactions, in a similar manner to other firm trades.

The amendments would address distribution of Index Swaption prices, both to Participants and publicly. The amendments also amend the governance provisions of the EOD Policy to incorporate the relevant functions of the ICC Risk Management Department regarding Index Swaptions. The table in the appendix setting out the timing for various aspects of the price submission process would also be updated to incorporate Index Swaptions.

The amendments would make certain other clarifications to the EOD Policy, including references to additional alternative price sources that ICC may use in establishing settlement prices. Certain clarifications would be made to the existing process for index and single name CDS Contracts to distinguish it from the additional submission process for Index Swaptions. Certain updates to defined terms and typographical and similar corrections would also be made.

Risk Framework Amendments

ICC would make conforming changes to its Risk Framework to incorporate the clearing of Index Swaptions. The amendments would, among other matters, define Index Swaptions and identify key terms of Index Swaptions, consistent with the Rules and EOD Policy. For risk management purposes, the Risk Framework would define an instrument as a specific combination of underlying index, expiration date, strike price, option type, exercise type, currency and transaction type. The amendments would address the application of the ICC initial margin model to Index Swaptions, including the integrated spread response component of the margin model, based on implied forward looking Index Swaption prices. Index Swaptions would not be eligible for index-single name decomposition benefits for purposes of determining the integrated spread response and accordingly would not be subject to basis risk requirements based on decomposed index positions. Certain price-based scenarios and jump to default requirements in the margin model would, in the case of Index Swaptions, be applied to delta equivalent notional amounts of the underlying index swap position. The framework would also apply concentration charges to Index Swaption positions, based on delta equivalent notional amounts of the underlying index.

Amendments to the Risk Framework would also remove certain outdated references and clarify certain risk management data and systems used in the margin models. Risk management review procedures contained in an appendix to the document would also be updated to incorporate Index Swaptions.

Core Principle Review:

ICC reviewed the DCO core principles ("Core Principles") as set forth in the Act. During this review, ICC identified the following Core Principles as being impacted:

Financial Resources: The revisions are consistent with the financial resources requirements of Core Principle B and the financial resource requirements set forth in Commission Regulation 39.33. The amendments provide for clearing of an additional type of contract, Index Swaptions. When exercised, Index Swaptions would result in the creation of an underlying index CDS Contract cleared by ICC. Index Swaptions would only relate to underlying index CDS Contracts that are accepted for clearing by ICC. As discussed above, ICC is modifying the Risk Framework, and in particular the initial margin model, to apply to Index Swaptions. With these modifications, ICC believes that its initial margin and guaranty fund resources will be sufficient to meet ICC's financial obligations to Participants with respect to cleared Index Swaptions as well as other cleared Contracts. As such, ICC will continue to maintain sufficient financial resources to withstand, at minimum, the default of the two Clearing Participant Affiliate Groups to which it has the largest exposure in extreme but plausible market conditions, consistent with the requirements of Commission Regulation 39.33.

Risk Management: The amendments are consistent with the risk management requirements of Core Principle D and the risk management requirements set forth in Commission Regulations 39.13 and 39.36. In general, the Rules would incorporate market-standard documentation for Index Swaptions (much as ICC does for other categories of cleared contract), with applicable changes to reflect the clearing process at ICC. The Rule amendments would also provide for the exercise of Index Swaptions by Swaption Buyers, and the assignment of exercised positions to Swaption Sellers, and the settlement of Index Swaptions following exercise. The revised EOD Policy would provide a means for daily pricing of Index Swaptions for settlement and margining purposes, in a manner similar to that for other cleared Contracts. In addition, the Risk Framework would be updated, principally to incorporate Index Swaptions into the ICC's initial margin model, among other risk management matters. In ICC's view, clearing of Index Swaptions on these terms and arrangements would extend the benefits of clearing to market participants that use these products, enhancing the functioning of the derivatives markets and providing increased ability for market participants to manage risk through the cleared environment. ICC believes that the amendments, as well as ICC's existing risk management procedures, would ensure that ICC possesses the ability to manage the risks associated with discharging its responsibilities, consistent with the risk management requirements of Core Principle D. ICC's risk management practices will also continue to be performed in accordance with the standards and practices set forth in Commission Regulations 39.13 and 39.36.

Participant and Product Eligibility: ICC has set appropriate standards in ICC's policies and procedures for determining the eligibility of contracts. 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. In ICC's view, the proposed amendments are consistent with the product eligibility requirements of Core Principle C and Commission Regulation 39.12.

Settlement Procedures: As described above, Index Swaptions will be physically settled in accordance with Subchapter 26R, and not the physical settlement rules in Chapter 22 (which may apply to the settlement of the Underlying Contract, if applicable, but not to the settlement of the Index Swaption). The amended Rules clearly set out the procedures for settlement of Index Swaptions on exercise, which result in the creation of a cleared underlying index CDS Contract (and in some cases in the event of a Restructuring Credit Event, an Underlying New Trade). The Rules also provide for settlements of credit events that occur prior to exercise of an Index Swaption, consistent with the documentation for such contracts. ICC believes that the proposed amendments are consistent with the requirements of Core Principle E and Commission Regulation 39.14.

Amended Rules:

The proposed changes consist of changes to the ICC Rules, ICC EOD Policy, and ICC Risk Framework. ICC has respectfully requested confidential treatment for the ICC EOD Policy and ICC Risk Framework, which were submitted concurrently with this submission.

Annexed as an Exhibit hereto is the following:

- A. Proposed amendments to the ICC Rules

Certifications:

ICC hereby certifies that the changes comply with the Act and the regulations thereunder. The changes were unanimously recommended for approval by the ICC Risk Committee and unanimously approved by the ICC Board of Managers. There were no substantive opposing views to the changes.

ICC further certifies that, concurrent with this filing, a copy of the submission was posted on ICC's website, and may be accessed at: <https://www.theice.com/clear-credit/regulation>

ICC would be pleased to respond to any questions the Commission or the staff may have regarding this submission. Please direct any questions or requests for information to the attention of the undersigned at (312) 836-6854.

Sincerely,

A handwritten signature in cursive script that reads "Maria Zyskind".

Maria Zyskind
Staff Attorney