

Maria Alarcon
Staff Attorney

December 17, 2019

**Re: Updates to ICC Rules Pursuant to
Section 5c(c)(1) of the Commodity Exchange
Act and Commission Regulation 40.6(a)**

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”) hereby submits, pursuant to Section 5c(c)(1) of the Commodity Exchange Act (the “Act”) and Commodity Futures Trading Commission (“Commission”) Regulation 40.6(a), a self-certification of changes to the ICC Clearing Rules (the “Rules”). ICC is registered with the Commission as a derivatives clearing organization (“DCO”). ICC intends to implement the changes no sooner than the tenth business day following the filing of this submission with the Commission at its Washington, D.C. headquarters and with its Chicago regional office.

ICC proposes revising its Rules¹ to incorporate amendments to the industry-standard ISDA 2014 Credit Derivatives Definitions (the “2014 Definitions”) that are being adopted in the broader CDS market to address so-called narrowly tailored credit events and related matters. This submission includes a description of the changes to the Rules. Certification of the changes pursuant to Section 5c(c)(1) of the Act and Commission Regulation 40.6(a) is also provided below.

ICE Clear Credit proposes amendments to its Rules to incorporate changes to the 2014 Definitions that are intended to address so-called “narrowly tailored credit events”. In the wake of certain credit events and potential credit events in the CDS market in recent years, the International Swaps and Derivatives Association, Inc. (“ISDA”), in consultation with market participants, has developed and published the 2019 Narrowly Tailored Credit Event Supplement to the 2014 ISDA Credit Derivatives Definitions (the “NTCE Supplement”).² The NTCE Supplement, if applied to a CDS transaction, effects two principal changes to the 2014 Definitions: (1) a change to the definition of the “Failure to Pay” credit event designed to exclude certain narrowly tailored credit events and (2) a change to the process for determining the Outstanding Principal Balance of an obligation to address certain obligations of a reference entity that were issued at a discount.

As described by ISDA in the attached guidance to the NTCE Supplement, the supplement was published in light of concerns among market participants and regulators about “instances of [CDS] market participants entering into arrangements with corporations that are narrowly tailored to trigger a credit event for CDS contracts while minimizing the impact on the corporation, in order to increase payment to the buyers of CDS protection.”³ ISDA has expressed concern that “narrowly tailored defaults . . . could

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

² The NTCE Supplement is published on the ISDA website at <https://www.isda.org/a/KDqME/Final-NTCE-Supplement.pdf>.

³ NTCE Supplement, Guidance on the interpretation of the definition of “Failure to Pay”.

negatively impact the efficiency, reliability and fairness of the overall CDS market.” Regulators have also expressed concern with narrowly tailored or manufactured credit events, including a joint statement by the heads of the Commission, the Securities and Exchange Commission and the UK Financial Conduct Authority that such strategies “may adversely affect the integrity, confidence and reputation of the credit derivatives markets, as well as markets more generally. These opportunistic strategies raise various issues under securities, derivatives, conduct and antifraud laws, as well as policy concerns.”⁴

With respect to the Failure to Pay credit event, the NTCE Supplement adopts a concept of a “Credit Deterioration Requirement.” If applicable, this requirement will provide that a failure of a reference entity to make a payment on an obligation will not constitute a Failure to Pay Credit Event if the failure “does not directly or indirectly either result from, or result in, a deterioration in the creditworthiness or financial condition” of the reference entity. As such, a “narrowly tailored” or “manufactured” failure to pay, which does not reflect or result in a credit deterioration, would not constitute a Credit Event for CDS Contracts that incorporate the NTCE Supplement and apply the Credit Deterioration Requirement. The NTCE Supplement also includes guidance as to factors relevant to the determination of whether credit deterioration has occurred. That determination would, under the 2014 Definitions, in the ordinary course be made by the relevant Credit Derivatives Determinations Committee.

The NTCE Supplement also amends the method of calculating the Outstanding Principal Balance of obligations. The amendments are intended to address a potential scenario where a corporation agrees to issue a bond at a substantial discount to its principal amount, where the bond could be delivered in settlement of a CDS at its full principal amount. Under the 2014 Definitions, the Quantum of the Claim (which is used to determine the Outstanding Principal Balance used in calculating settlement obligations) is determined taking into account any applicable laws insofar as they reduce the size of the claim to reflect the original issue price or accrued value of the obligation. The NTCE Supplement clarifies that the applicable laws to be considered include any bankruptcy or insolvency law or other law affecting creditors’ rights to which the relevant obligation is or may become subject. In addition, the NTCE Supplement includes the concept of “Fallback Discounting,” which if designated to be applicable, provides a method for discounting the Quantum of the Claim (where it is not otherwise reduced under applicable law or pursuant to its own terms) of an obligation that is issued at less than 95% of its principal amount, based on straight-line interpolation between the issue price and the principal amount.

ICE Clear Credit has been advised that CDS market participants are expected to commence transacting in CDS incorporating the NTCE Supplement (with Credit Deterioration Requirement and Fallback Discounting applicable) on or about January 27, 2020. In addition, ISDA has published, and opened for adherence, an NTCE Protocol pursuant to which parties may, on a multilateral basis, agree to amend outstanding, non-cleared CDS transactions to incorporate the NTCE Supplement. The amendments made by the NTCE Protocol are also expected to have an implementation date on or about January 27, 2020. Adherence to the protocol will thus make existing transactions fungible with transactions on the new terms. Accordingly, ICE Clear Credit is proposing to amend its Rules for relevant products to incorporate the NTCE Supplement, both for new and existing cleared transactions. For this purpose, the proposed ICC amendments will apply to all cleared CDS contracts with corporate (i.e., non-sovereign) reference entities, consistent with the NTCE Protocol and the expected approach for new CDS transactions. ICC proposes to make such changes effective by the industry implementation date.

Specifically, ICC would amend Rule 20-102 to include new definitions for “NTCE Amending Contracts”, which would be those Contracts being amended to incorporate the NTCE Supplement, as specified in a list to be maintained by ICC, and “NTCE Effective Date”, which will be the date of implementation of the amendment. The NTCE Effective Date will initially be January 27, 2020 (or such later date as designated by ICC by Circular). Rule 20-102 would also include a definition for the NTCE Supplement.

⁴ Securities and Exchange Commission, Commodity Futures Trading Commission and UK Financial Conduct Authority, Joint Statement on Opportunistic Strategies in the Credit Derivatives Markets (June 24, 2019); see also Update to June 2019 Joint CFTC-SEC-FCA Statement on Opportunistic Strategies in the Credit Derivatives Market (Sept. 19, 2019).

ICC would further amend each relevant subchapter of Chapter 26 of the Rules to implement the NTCE Supplement. A set of amendments would apply to index CDS transactions and a separate set of amendments would apply to single-name CDS transactions.

In the case of index CDS, for CDX.NA Index CDS transactions, in subchapter 26A, in Rule 26A-102, the definition of CDX.NA Untranchured Terms Supplement would be amended to include the new 2020 standard terms supplement for such transactions, as published by ISDA, which incorporates the NTCE Supplement, along with conforming changes to cross-references. Rule 26A-316 would be amended by adding a new paragraph (e), which provides that open positions in CDX.NA Untranchured Contracts that are NTCE Amending Contracts would be amended, effective as of the NTCE Effective Date, to reference the updated 2020 standard terms supplement in lieu of the standard terms supplement previously in effect. This will have the effect of converting all existing CDX.NA Untranchured Contracts to reference the new standard terms supplement, such that they will be fungible with new CDX.NA Untranchured Contracts, which will also reference the new standard terms supplement. New paragraph (e) would also provide that the amendments will be effective regardless of whether any transaction record in the Deriv/SERV warehouse is updated to reflect the change.

Substantially similar changes for other categories of index CDS would also be made in subchapters 26F (for iTraxx Europe Untranchured Contracts) and 26J (for iTraxx Asia/Pacific Untranchured Contracts).

In the case of single-name CDS, for Standard North American Corporate (SNAC) Contracts, in subchapter 26B, Rule 26B-616 would be amended by adding a new paragraph (c), which provides that open positions in SNAC Contracts that are NTCE Amending Contracts would be amended, effective as of the NTCE Effective Date, to incorporate the NTCE Supplement and specify that Fallback Discounting and Credit Deterioration Requirement will be applicable. The contracts would also be amended to reference the new ISDA physical settlement matrix, to be published as of the NTCE Effective Date (or other relevant implementation date as determined by ICC). The amendments will have the effect of converting existing SNAC Contracts to reference the updated physical settlement matrix, such that they will be fungible with new SNAC Contracts, which will also reference that matrix. New paragraph (c) would also provide that the amendments will be effective regardless of whether any transaction record in the Deriv/SERV warehouse is updated to reflect the change.

Substantially similar changes for other categories of single-name CDS would also be made in subchapters 26G (for Standard European Corporate Contracts), 26H (for Standard European Financial Corporate Contracts), 26M (for Standard Australian Corporate Contracts), 26N (for Standard Australia Financial Corporate Contracts), 26O (for Standard Asia Corporate Contracts), 26P (for Standard Asia Financial Corporate Contracts) and 26Q (for Standard Emerging Market Corporate Contracts).

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:

Participant and Product Eligibility: The revisions to the ICC Rules are consistent with the participant and product eligibility requirements of Core Principle C. The amendments incorporate changes to the standard terms of CDS Contracts that are being widely adopted by market participants to address potential concerns that have arisen with so-called narrowly tailored credit events.

Legal Risk: The revisions to the ICC Rules are consistent with the requirements of Core Principle R and Commission Regulation 39.27. The amendments reflect amendments to the 2014 Definitions, specifically with respect to the Failure to Pay and Outstanding Principal Balance definitions, that have been developed by ISDA, in consultation with market participants in both the cleared and uncleared CDS markets, and are set out in the NTCE Supplement. ICE Clear Credit understands that for the uncleared swap market, these amendments are expected to be widely implemented through the NTCE Protocol. ICE Clear Credit is proposing to adopt amendments to its Rules to implement these same changes for both new and existing contracts cleared by it. The amendments to the Rules are designed to supplement

the contractual terms, consistent with industry initiatives, to address and reduce the likelihood of certain situations involving narrowly tailored credit events that have given rise to concerns among market participants and regulators, as described above. As such, ICC believes that the amendments will enhance the legal framework for clearing of CDS Contracts. ICC does not believe that the amendments will adversely impact its ability to comply with any Core Principles or Commission regulations. In ICC's view, the proposed changes are thus consistent with the legal risk considerations of the clearing house under Core Principle R and Commission Regulation 39.27.

Risk Management: The revisions to the ICC Rules are consistent with the risk management requirements of Core Principle D. ICC believes the amendments, by implementing the NTCE Supplement for existing and new CDS Contracts, will be consistent with, and eliminate basis risk as compared to, changes being made in the uncleared CDS markets. The changes will also ensure the fungibility of new and existing contracts in light of the NTCE Supplement amendments, which will facilitate ongoing risk management by the clearing house and market participants. As a result, in ICC's view, the amendments continue to ensure that ICC possesses the ability to manage the risks associated with discharging its responsibilities and are consistent with Core Principle D.

Amended Rules:

The proposed changes consist of changes to Chapters 20 and 26 of the ICC Rules.

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. 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,



Maria Alarcon
Staff Attorney