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

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–79750; File No. SR–ICC–2016–013]

### Self-Regulatory Organizations; ICE Clear Credit LLC; Notice of Filing Amendment No. 1 and Order Granting Accelerated Approval of Proposed Rule Change To Amend the ICE Clear Credit Clearing Rules, as Modified by Amendment No. 1, Relating to Default Management, Clearing House Recovery and Wind-Down

January 6, 2017.

#### I. Introduction

On November 4, 2016, ICE Clear Credit LLC (“ICC” or “clearing house”) 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 (SR–ICC–2016–013) to amend the ICC Clearing Rules (“ICC Rules” or “Rules”) relating to clearing house default management, recovery, and wind-down, and to adopt certain related default auction procedures. The proposed rule change was published for comment in the **Federal Register** on November 22, 2016. <sup>3</sup> The Commission received one comment letter to the proposed rule change. <sup>4</sup> On December 19, 2016, ICC filed Amendment No. 1 to the proposed rule change. The Commission is publishing this notice to solicit comment on Amendment No. 1 from interested persons and, for the reasons stated below, is approving the proposed rule change, as modified by Amendment No. 1, on an accelerated basis.

#### II. Description of the Proposed Rule Change and Notice of Filing of Amendment No. 1

ICC has proposed changes to the ICC Rules, as modified by Amendment No. 1, relating to clearing house default management, recovery, and wind-down to address uncovered losses from a clearing participant (“Participant”) default or series of Participant defaults. The proposed changes consist of three aspects. First, ICC proposes to revise its auction procedures and tools for returning to a matched-book after a Participant default or series of Participant defaults and to implement a different approach to allocating uncovered losses stemming from such Participant default(s) that provides more certainty to Participants by limiting their exposure to ICC. Second, ICC proposes to collect additional initial margin to ensure that it maintains minimum pre-funded financial resources in compliance with applicable regulatory requirements. Third, ICC proposes to clarify the governance requirements relating to the use of ICC’s proposed default management tools, including matched-book tools and loss allocation tools, as well as clarify the Rules to enhance transparency and specificity.

##### *A. Revised Auction Procedures, Tools for Returning ICC to a Matched-Book and Tools for Default Loss Allocation*

ICC proposes substantial changes in the way it returns to a matched-book following a Participant default or series of defaults. Specifically, ICC proposes to maintain its existing default management practices, <sup>5</sup> such as the practice of auctioning a defaulting Participant’s positions to its non-defaulting Participants, but proposes to eliminate its ability to forcibly allocate a defaulting Participant’s positions to other non-defaulting Participants, in the event an auction is unsuccessful. In lieu of these forced allocations, ICC has proposed a revised set of auction procedures and an additional matched-book tool. The revised auction procedures include initial and secondary auctions, each of which include a number of features designed to incentivize Participants and their customers to bid competitively. In the event that the default management auctions are unsuccessful in returning ICC to a matched-book, ICC proposes to

terminate any positions of non-defaulting Participants (or their customers) that exactly offset the unsuccessfully auctioned positions in the defaulting Participant’s portfolio. ICC refers to this termination of a discrete set, as opposed to all, of its outstanding positions as “partial tear-up.” Separately, ICC proposes to revise its authority to seek unlimited guaranty fund assessments from its Participants and implement a “cooling-off period,” during which its ability to call for additional Participant contributions to the guaranty fund is capped. In addition, ICC proposes, in a highly limited set of circumstances, to allocate losses by reducing the amount of variation margin that would otherwise be owed to Participants or their customers as a tool to assist in ICC’s recovery, which ICC refers to as “reduced gains distributions.” These provisions are described more fully below. <sup>6</sup>

##### 1. Revised Auction Procedures

Under the proposed changes, ICC will use an auction to dispose of a defaulting Participant’s portfolio. <sup>7</sup> Ordinarily, ICC will begin with an initial default auction and if necessary or appropriate proceed to a secondary auction. But, in consultation with the Risk Committee, if practicable, and upon a majority vote of ICC’s Board, ICC may bypass the initial auction and proceed directly to a secondary auction.

In the initial auction, ICC management will divide the defaulting Participant’s portfolio into one or more lots, and each non-defaulting Participant will be subject to a minimum bid requirement for each lot. In addition, ICC proposes to permit customers of Participants to participate in the initial auction either by bidding indirectly through a Participant or by bidding directly in the auction, provided that such customers (1) agree to the terms of the auction, (2) accept the same confidentiality agreements concerning the auction as a Participant; and (3) make a minimum deposit to be applied by ICC in the same manner as Participants’ guaranty fund contributions. ICC will use all available default resources to cover the costs associated with the initial default

<sup>6</sup> See Notice, 81 FR at 83906–10, unless otherwise noted.

<sup>7</sup> Although the auction procedures will not be published, ICC will make such procedures available to all Participants, subject to existing confidentiality arrangements between ICC and Participants and the confidentiality provisions set forth in the auction procedures. ICC will also make such procedures available to customers of Participants at the request of such customers (and/or permit Participants to do so), subject to confidentiality arrangements.

<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> Securities Exchange Act Release No. 34–79324 (Nov. 16, 2016), 81 FR 83906 (Nov. 22, 2016) (SR–ICC–2016–013) (“Notice”).

<sup>4</sup> See letter from Jacqueline H. Mesa, Senior Vice President of Global Policy, FIA (Dec. 2, 2016) (“FIA Comment”).

<sup>5</sup> ICC’s existing default remedies, as amended by this proposed rule change, are referred to as “Standard Default Management Actions.” By contrast, additional, new default management tools adopted as part of this proposed rule change are referred to as “Secondary Default Management Actions.” See Notice, 81 FR at 83906.

auction. These resources include all mutualized guaranty fund contributions, whether pre-funded or assessed, including ICC's "pro rata" contribution. In an effort to encourage competitive bidding, ICC will "juniorize," *i.e.*, apply the guaranty fund contributions of Participants who fail to bid and those who bid non-competitively to the costs of the auction before it applies those of Participants who bid competitively, as set forth in the default auction procedures.

As part of this proposed rule change, ICC proposes to move its contribution to the guaranty fund higher in the default waterfall such that ICC's contribution will be used prior to the application of guaranty fund contributions of non-defaulting Participants.

In the event an initial auction does not fully dispose of a defaulting Participant's portfolio, ICC may conduct one or more secondary auctions. At the secondary auction stage, ICC will endeavor to auction off the remaining portfolio in a single lot, though ICC retains the discretion to break the portfolio into separate lots if certain non-defaulting Participants are not able to bid on particular positions or ICC otherwise determines that doing so would facilitate the auction process. Moreover, customers of Participants are permitted to bid in secondary auctions directly without the need for a minimum deposit, so long as a Participant has confirmed that it would clear any resulting transactions of the customer. (Customers of Participants continue to retain the option of bidding indirectly through a Participant as well.) As with initial auctions, ICC will apply all remaining default resources to fund the secondary auction(s), and it will continue to juniorize guaranty fund contributions that remain, if any. A secondary auction for any lot is deemed successful if it results in a price that is within ICC's remaining default resources. If a secondary auction is unsuccessful for any lot, ICC may run another secondary auction for that lot on a subsequent business day, unless ICC has invoked reduced gains distributions, in which case secondary auctions may not extend beyond the five business-day reduced gains distributions period.

## 2. Removal of Forced Allocation and Addition of Partial Tear-Up

ICC further proposes to eliminate its rules regarding forced allocation, in which all positions not successfully auctioned through the default auction process are allocated to non-defaulting Participants, and instead, implement pro rata partial tear-up to return to a

matched book. Partial tear-up entails terminating the positions of non-defaulting Participants (and their customers) that exactly offset those in the defaulting Participant's remaining portfolio (*i.e.*, positions in the identical contracts and in the same aggregate notional amount). Partial tear-up will be employed on both house and customer origin accounts across all non-defaulting Participants that have such positions on a pro rata basis. ICC proposes to base the partial tear-up price on the last established end-of-day mark-to-market settlement price and terminate selected contracts contemporaneously with the determination of such price (*i.e.*, at 5 p.m., New York time). Thus, ICC proposes to collect and pay the tear-up price by application of mark-to-market margin posted (or that would have been posted but for reduced gains distributions) as part of its end-of-day settlement process. After a partial tear-up is executed, ICC would return to a matched-book and would be positioned to continue offering clearing services for all remaining Participants and their customers.

ICC may invoke partial tear-up as a matched-book tool only after a number of prerequisites have been satisfied. First, ICC may not resort to partial tear-up until it has attempted one or more initial or secondary auctions. In addition, ICC must consult with its Risk Committee, which is comprised of a supermajority of Participants, if practicable, before it may proceed to partial tear-up. If consultation with the Risk Committee is impracticable prior to taking action, ICC must use its reasonable best efforts to consult with the Risk Committee as soon as practicable thereafter regarding any further relevant actions. Moreover, only ICC's Board, which is comprised of a majority of directors independent of ICC and includes directors chosen by Participants and may also include Participant representatives, may invoke partial-tear up.

## 3. Cooling-Off Period, Participant Withdrawal, and Reduced Gains Distributions

ICC's current rules permit the clearing house to seek unlimited guaranty fund assessments from its Participants, but the proposed rule change would eliminate the clearing house's unlimited power of assessment. Instead, ICC proposes to implement a "cooling-off period," during which its ability to call for additional Participant contributions to the guaranty fund is limited. During a cooling-off period, non-defaulting Participants will not be required to pay more than one time their required

guaranty fund contribution per default. And during the cooling-off period, non-defaulting Participants' liability for mutualized guaranty fund contributions is capped at three times the required guaranty fund contribution, based on the last guaranty fund calculation before the cooling-off period was triggered, regardless of the number of defaults that occur during this period. Similarly, ICC's contributions to the guaranty fund are subject to limits of one times its contribution per default and three times its contribution during the cooling-off period. Participants may terminate their membership during a cooling-off period by providing ICC with an irrecoverable notice of withdrawal and closing out all positions by a specified deadline. Participants who withdraw during a cooling-off termination period must continue to meet their obligations to ICC, including guaranty fund assessments with respect to defaults and potential defaults that occur before such Participants' withdrawal becomes effective, subject to the limits described above.

ICC further proposes to use reduced gains distributions as a tool to allocate losses stemming from the defaulting Participant's variation margin obligations while ICC attempts a secondary auction or conducts a partial tear-up during default management and recovery. Currently, holders of positions opposite those of a defaulting Participant are entitled to receive variation margin each day such positions appreciate in value. Under the proposed rule change, ICC may reduce variation margin that would be otherwise owed to both Participants and their customers. ICC proposes to use reduced gains distributions for no more than five business days. On each day when reduced gains distributions are invoked, ICC will calculate a haircut that is applied pro rata to house and customer origin accounts and applied pro rata to each customer portfolio such that each customer portfolio receives the same haircut.

Under the proposed rule change, the use of reduced gains distributions is subject to certain conditions. ICC may not resort to reduced gains distributions unless it has exhausted all available financial resources and expects that there will be favorable conditions for completing a successful secondary auction, subject to the limitation that reduced gains distributions may not extend for more than five business days. In the event ICC conducts a successful secondary auction, reduced gains distributions will end on that day. If ICC has been unable to conduct a successful secondary auction by the end of the five

business day reduced gains distributions period, ICC will proceed to partial tear-up, as described above, at the close of business on such fifth business day. Moreover, as further clarified in Amendment No. 1, reduced gains distributions will not be available to provide additional funds for a secondary auction, and projected auction costs will not be factored into the amount of reduced gains distributions. Finally, as with partial tear-up, ICC must consult with its Risk Committee before invoking reduced gains distributions, to the extent practicable, and the ultimate decision to do so must be made by the Board.

#### B. Additional Initial Margin

ICC further proposes to levy additional initial margin, if necessary, during a cooling-off period when Participants' obligations to replenish the guaranty fund and to make required guaranty fund contributions (*i.e.*, assessments) have reached the cap described above, in order to maintain sufficient financial resources that would enable the clearing house to withstand a default by the two Participant families to which it has the largest exposure in extreme but plausible market conditions (*i.e.* the "cover two" standard), as required by Exchange Act Rule 17Ad-22(b)(3). The additional initial margin will be calculated in an amount such that ICC has collected sufficient financial resources to meet the regulatory requirement.

#### C. Governance

ICC further proposes enhanced governance requirements for the use of certain default management tools as part of the proposed rule change. Under the proposed rule change, ICC is required to consult with the Risk Committee (which consists of a supermajority of Participant representatives) on whether to conduct a secondary auction, employ reduced gains distributions, implement partial tear-up, or proceed to wind-down the service. If such consultation is impracticable, ICC must use its reasonable best efforts to consult with the Risk Committee as soon as practicable thereafter regarding any further relevant actions. In addition, ICC's management is not permitted to invoke partial tear-up or reduced gains distributions on its own authority. Those decisions may only be undertaken after majority vote of the ICC Board, which itself is composed of a majority of directors independent of ICC.

To complement its governance provisions, ICC has also proposed several clarifications to enhance the

transparency of its Rules. With respect to clearing service termination, ICC proposes to establish more specific procedures governing a number of matters, such as the notice of and timing of clearing service termination, the calculation of termination prices, and the determination of the net amount owed to or by each Participant. In addition, ICC has made a number of additional changes to the existing rules to clarify that its emergency authority does not override the limitations on Participant obligations to make guaranty fund contributions during a cooling-off period or permit resort to partial tear-up, unless otherwise permitted under the Rules, as well as a number of more minor drafting enhancements.

#### D. Notice of Filing of Amendment No. 1

In Amendment No. 1, ICC proposes to clarify certain aspects of the proposed rule change. In particular, as noted above, ICC explains that reduced gains distributions will not be used to provide additional funds for a secondary auction, and that expected auction costs will not be factored into the determination of the haircut used for reduced gains distributions. In addition, ICC clarifies that additional initial margin called after the cap on guaranty fund replenishments and assessments in a cooling-off period is reached will be calculated not only for the house account, but also customer accounts (on a net basis across customers). Any margin amounts charged, however, will be charged to the house account of the Participant, with no charge against any customer accounts. Finally, ICC notes that the ability to call for the additional initial margin after the cap on guaranty fund replenishments and assessments has been reached may have a procyclical impact on Participants and their customers. However, ICC believes that any additional initial margin called will likely not exceed the amount of initial margin otherwise on deposit, and will be commensurate with the range of initial margin variation experienced in the ordinary course.

### III. Summary of Comment Letter

The Commission received one comment letter in response to the proposed rule change.<sup>8</sup> The commenter, a trade association, provided general comments on three broad issues: (1) The use of variation margin gains haircutting ("VMGH") and partial tear-ups; (2) compensation for losses beyond mutualized resources; and (3) full

clearing service termination,<sup>9</sup> but did not take a position regarding any of these three issues or provide any legal analysis regarding whether ICC's use of VMGH, *i.e.*, reduced gains distributions, or partial-tear up or other aspects of ICC's proposal is consistent with the Exchange Act. The commenter did suggest that ICC be required to consult not only with its Risk Committee, but also with all members when "invoking tools that impact loss distributions after the exhaustion of funded and unfunded resources."<sup>10</sup>

### IV. Discussion and Commission Findings

Pursuant to section 19(b)(2)(C)<sup>11</sup> of the Act, the Commission must approve a proposed rule change of a self-regulatory organization if the Commission finds that such proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to such self-regulatory organization. After careful consideration, the Commission believes that the proposed rule changes are consistent with the Act and the rules and regulations thereunder applicable to ICC.

Specifically, Section 17A(b)(3)(F) of the Act requires,<sup>12</sup> among other things, that the rules of a clearing agency 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 and to protect investors and the public interest. Exchange Act Rule 17Ad-22(d)(11) requires,<sup>13</sup> in part, each registered clearing agency to establish, implement, maintain, and enforce written policies and procedures reasonably designed to make key aspects of the clearing agency's default procedures publicly available and establish default procedures that ensure that the clearing agency can take timely action to contain losses and liquidity pressures and to continue meeting its obligations in the event of a participant

<sup>9</sup> With regard to the use of VMGH and partial tear-up, the commenter noted that its members have varying, sometimes inconsistent views on the desirability of using VMGH or partial tear-up in recovery. Similarly, the commenter noted that there is a disagreement within its membership as to whether ICC should be able to terminate all trades without recourse to ICC capital. With regard to compensation for losses beyond mutualized resources, the commenter expects to engage ICC on this topic and does not argue that this is a basis upon which the proposed rule change can or should be disapproved. *See id.*

<sup>10</sup> *See id.*

<sup>11</sup> 15 U.S.C. 78s(b)(2)(C).

<sup>12</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>13</sup> 17 CFR 240.17Ad-22(d)(11).

<sup>8</sup> See FIA Comment, *supra* note 4.

default. Furthermore, Exchange Act Rule 17Ad-22(b)(3) requires, in part, each registered clearing agency providing central counterparty services to establish, implement, maintain, and enforce written policies and procedures reasonably designed to maintain certain financial resource requirements at all times,<sup>14</sup> including during the default management process and in the clearing house recovery scenario. Finally, Exchange Act Rule 17Ad-22(d)(8) requires a clearing agency to establish, implement, maintain, and enforce written policies and procedures reasonably designed to have governance arrangements that are clear and transparent to fulfill the public interest requirements in Section 17A of the Act, to support the objectives of owners and participants, and to promote the effectiveness of the clearing agency's risk management procedures.<sup>15</sup>

The Commission discusses each aspect of ICC's proposed rule change and its findings below.

#### *A. Revised Auction Procedures, Tools for Returning ICC to a Matched-Book and Tools for Default Loss Allocation*

##### 1. Revised Auction Procedures

The Commission finds the revised auction procedures, as proposed by ICC, consistent with Section 17A(b)(3)(F) and Exchange Act Rule 17Ad-22(d)(11). As described above, under the proposed rule change, in the event of a Participant default, ICC will ordinarily conduct an initial auction as part of its Standard Default Management Actions.<sup>16</sup> Under the proposed auction procedures, Participants will be required to bid in the initial auction for each lot in a minimum amount determined by ICC. In addition, the revised auction procedures will permit customers of Participants to participate in auctions by either bidding indirectly through a Participant or by bidding directly in the auction, provided that such customers (1) agree to the terms of the auction, (2) accept the same confidentiality agreements concerning the auction as a Participant; and (3) make a minimum deposit to be applied by ICC in the same manner as Participants' guaranty fund contributions. Furthermore, the guaranty fund and assessment contributions of non-defaulting Participants will be subject to juniorization and applied using a defined default auction priority set out

in the default auction procedures based on the competitiveness of their bids.

If the initial auction fails, as described above, ICC may conduct a secondary auction to maximize the opportunities of disposing of the defaulting Participant's portfolio and returning to a matched-book. Similar to the initial auction, ICC would juniorize the guaranty fund and assessment contributions that remain, if any, of non-defaulting Participants with less competitive bids in order to incentivize competitive bidding by such Participants. In addition, at the secondary auction stage, ICC will apply all remaining clearing house default resources and endeavor to auction off the remaining portfolio in a single lot, although it may break the portfolio into separate lots if certain Participants are not able to bid on particular contracts or it otherwise determines that doing so would facilitate the auction process. A secondary auction for a lot will be deemed successful if it results in a price for the lot that is within ICC's remaining default resources. The secondary auction procedures would make it even easier for customers to bid directly by eliminating the need for a minimum deposit, so long as a Participant has confirmed that it would clear any resulting transactions of the customer. (As with initial auctions, customers retain the option of bidding through a Participant.) If a secondary auction is unsuccessful for any lot, ICC may repeat this process and run another secondary auction for that lot on a subsequent business day, unless ICC has invoked reduced gains distributions, in which case, the secondary auctions may not extend beyond the five-business-day reduced gains distributions period.<sup>17</sup>

Taken together, the Commission believes that the revised default auction procedures, including the assignment of minimum bid requirements to Participants during the initial auction, broadening participation in both the initial auction and the secondary auctions by permitting customers of Participants to bid directly or indirectly, and juniorization of the guaranty fund and assessment contributions of non-defaulting Participants and the minimum deposit of customers, provide Participants and applicable customers of Participants who elect to participate in the auction a strong incentive to bid competitively. The revised auction procedures should significantly increase the likelihood of reaching an efficient auction clearing price that permits ICC successfully to dispose of the defaulting Participant's portfolio within the

resources of the clearing house. Therefore, Commission believes that the revised auction procedures are reasonably designed to establish default procedures that ensure that the clearing agency can take timely action to contain losses and to continue meeting its obligations in the event of a participant default, as well as promoting safeguarding securities and funds, consistent with the requirements in Section 17A(b)(3)(F) of the Act and Exchange Act Rule 17Ad-22(d)(11).

In addition, the Commission finds the proposal to move ICC's contribution to the guaranty fund to the beginning of the waterfall is consistent with the Act. Subordination of ICC's guaranty fund contribution reinforces its incentives to manage risk appropriately and safeguard the securities and funds with which it has been entrusted, and therefore, is consistent with the requirements in Section 17A(b)(3)(F) of the Act.

##### 2. Removal of Forced Allocation and Addition of Partial Tear-Up

The Commission further finds that the removal of forced allocation and addition of partial tear-up, as proposed by ICC, are consistent with the Exchange Act. As described above, if any positions are not successfully auctioned through the default auction process, ICC proposes pro-rata partial tear-up in lieu of the existing forced allocation.<sup>18</sup> As a result of the partial tear-up, ICC would return to a matched book.

The Commission recognizes that the replacement of forced allocation with partial tear-up as a matched-book tool would result in termination of positions of non-defaulting Participants across both the house and customer origin accounts that exactly offset those in the defaulting Participant's portfolio that are not successfully auctioned off during the initial and/or secondary auctions. However, the Commission also recognizes that the forced allocation of positions in a defaulting Participant's remaining portfolio that cannot be successfully disposed of with the clearing house's financial resources would potentially result in non-defaulting Participants taking unmeasurable and unlimited losses beyond their risk tolerance or risk management capability. Because ICC will only be permitted to use partial tear-up to return to a matched book after it has attempted initial and/or secondary auctions, as appropriate, and the proposed auction procedures would significantly improve the likelihood of successful auctions, the use of the

<sup>14</sup> 17 CFR 240.17Ad-22(b)(3).

<sup>15</sup> 17 CFR 240.17Ad-22(d)(8).

<sup>16</sup> In consultation with the Risk Committee, if practicable, and with a majority vote of the Board, ICC may proceed directly to Secondary Default Management Actions if appropriate.

<sup>17</sup> See ICC Rule 808(e).

<sup>18</sup> See ICC Rules 809 and 20-605(f)(iii).

partial tear-up would only arise in an extreme stress scenario. In such a stress scenario, the forced allocation of a defaulting Participant's remaining positions that could not be auctioned off also could pose risk to non-defaulting Participants and threaten systemic financial stability by, among other things, precipitating further defaults among such Participants. On the other hand, use of partial tear-up could potentially return the clearing house to a matched book quickly, thereby containing the clearing house's losses. Pursuant to the proposed rule change, ICC would base the partial tear-up price on the last established end-of-day mark-to-market settlement price and terminate selected contracts contemporaneously with the determination of such price (*i.e.*, at 5 p.m., New York time).<sup>19</sup> This would enable ICC to collect and pay the tear-up price by application of mark-to-market margin posted (or that would have been posted but for reduced gains distributions) as part of its end-of-day settlement process. Once the partial tear-up is completed through the end-of-day mark-to-market settlement process, ICC would have the ability to promptly return the initial margin associated with the terminated positions to the Participants and customers whose positions have been terminated pursuant to ICC's existing rules. Finally, pursuant to the proposed rule change, ICC must consult with the Risk Committee, if practicable, and obtain the Board's approval before invoking partial tear-up, which ensures that Participants have the opportunity to provide input in the decision-making process with respect to whether the clearing house should initiate partial tear-up.

The Commission believes that these provisions regarding the use of partial tear-up and the removal of forced allocation are designed to provide greater certainty to Participants in the estimation of their potential risks and losses in their use of the clearing agency, while enabling ICC to promptly return to a matched book. The Commission believes that returning to a matched book pursuant to these provisions in the context of ICC's default management and recovery, facilitates the timely containment of default losses and liquidity pressures and is consistent with the safeguarding of assets and funds and, to the extent of limiting contagion to the broader financial system, is consistent with the protection of investors and the public interest as well—consistent with

Section 17A(b)(3)(F) and Exchange Act Rule 17Ad-22(d)(11).

### 3. Cooling-Off Period, Participant Withdrawal, and Reduced Gains Distributions

With respect to financial resources available during default management and clearing house recovery, ICC also proposes to impose a cooling-off period, to permit Participants to withdraw from ICC during the cooling-off period, and to use reduced gains distributions when all the other default resources have been exhausted. The Commission believes that these changes, subject to the conditions and the governance arrangements proposed by ICC in conjunction therewith, are consistent with the requirements of prompt and accurate clearance and settlement, safeguarding securities and funds and promoting public interest and investor protection in the Act, and the rules and regulations thereunder.

As described above, during the proposed cooling-off period, Participants' obligations for assessments would be capped at "1x" the required guaranty fund contribution per default, and each Participant's total amount of replenishments and assessment contributions would be capped at three times the required guaranty fund contribution, regardless of the number of defaults during the period. In addition, Participants who seek to withdraw from ICC during a cooling-off period must generally provide ICC with an irrecoverable notice of withdrawal and close out all positions by a specified deadline. The Commission recognizes that these provisions would effectively limit the amount of financial resources available to ICC for covering default losses, even though a withdrawing Participant will continue to meet its obligations, including guaranty fund assessments, with respect to defaults and potential defaults before such withdrawal becomes effective, subject to the cap described above. However, these provisions also provide certainty regarding Participants' ultimate exposure to the clearing house in connection with their use of clearing services and provide clarity with respect to the distinction between additional guaranty fund contributions (*i.e.*, assessment) and replenishment obligations, as well as when participant withdrawal is effective. In an extreme stress scenario, where multiple calls for assessments or sequential guaranty fund depletion have occurred, capping Participants' obligations and permitting Participant withdrawal could well have stabilizing effects on the financial market.

Because the proposed rule change would not subject Participants to unlimited assessment calls, ICC further proposes reduced gains distributions as a tool to manage the limitation the proposed rule change places on its financial resources while the clearing house attempts a secondary auction or conducts a partial tear-up during default management and recovery.<sup>20</sup> Since reduced gains distributions will allow ICC to reduce payment of variation margin, or mark-to-market, gains that would otherwise be owed to Participants or their customers, reduced gains distributions will be used only on an extremely limited basis, with appropriate input from the Risk Committee in order to minimize the negative impact on Participants or customers. Pursuant to the proposed rule change, the implementation of reduced gains distributions will be subject to certain conditions, including the condition that ICC has exhausted all other available default resources and has determined that reduced gains distributions are appropriate in connection with a secondary auction or partial tear-up. As described above, ICC must, to the extent practicable, consult with the Risk Committee, which is predominantly comprised of Participants, before using reduced gains distributions, and any decision to use reduced gains distributions must be made by the ICC Board, which as noted above, is independent of ICC and must include members chosen by Participants and may also include Participant representatives.<sup>21</sup>

It should also be noted that under the proposed rule change, as clarified by Amendment No. 1, the use of reduced gains distributions is not intended to pay for the auction costs; rather, it is designed to provide additional time and liquidity needed (no more than five business days) to enable completion of a successful secondary auction or partial tear-up that would not otherwise be possible because all other default resources have been exhausted. Thus, reduced gains distributions will not be used as a source of funds for a secondary auction, and projected auction costs will not be factored into the amount of any reduced gains distributions.

The proposed rule change also limits the use of reduced gains distributions to no more than five business days, and even during this limited period, ICC may not continue to invoke reduced gains distributions to keep the clearing house going if there is no reasonable

<sup>19</sup> See ICC Rules 809(b)(iv) and (d).

<sup>20</sup> See ICC Rules 20-605(f)(i) and 808.

<sup>21</sup> See ICC Rules 20-605(l)(iv) and (v).

prospect of a successful auction. Pursuant to the proposed rule change, at the end of each day in the five-business-day period, ICC must determine whether it expects that there will be favorable conditions for completing a successful secondary auction.<sup>22</sup> If so, ICC may continue the reduced gains distributions for that day. The proposed rule change also provides that, if ICC conducts a successful secondary auction on any day, any reduced gains distributions period that is in effect will end. If ICC has been unable to conduct a successful secondary auction by the end of the five business day reduced gains distributions period, ICC will proceed to conduct a partial tear-up described above, as of the close of business on such fifth business day.<sup>23</sup> As such, the Commission believes the cooling-off period, Participant withdrawal, and reduced gains distributions, taken together with the other components of ICC's default management procedures and recovery rules, are reasonably designed to provide ICC with financial resources it needs to cover default losses and to ensure that ICC can take timely Standard Default Management Actions and/or Secondary Default Management Actions, including auctions, to contain losses and liquidity pressures and to continue meeting its obligations in the event of Participant defaults, in accordance with Exchange Act Rule 17Ad-22(d)(11),<sup>24</sup> while at the same time providing Participants and their customers with greater certainty and predictability with respect to the amount of losses they must bear as a result of a Participant default, which could potentially limit loss contagion in the broader financial system, consistent with the public interest requirement under Section 17A(b)(3)(F).<sup>25</sup>

#### *B. Additional Initial Margin*

The Commission further finds the aspect of the proposed rule change that would require Participants to provide additional initial margin during the cooling-off period is consistent with applicable rules. Exchange Act Rule 17Ad-22(b)(3) provides, in part, that a registered clearing agency that performs central counterparty services for security-based swaps must establish, implement, maintain, and enforce written policies and procedures reasonably designed to maintain

sufficient financial resources to meet the cover two standard.<sup>26</sup>

As described above, the proposed rule change will require Participants to provide additional initial margin in the event the cap on Participant guaranty fund assessments and replenishment during a cooling-off period described above is reached. The amount of such initial margin would be determined by ICC based on the applicable regulatory financial resources requirements during the remainder of the cooling-off period. The Commission finds that the additional initial margin requirement is reasonably designed to ensure that ICC would maintain sufficient financial resources meeting the cover two standard and therefore, consistent with the requirement of Exchange Act Rule 17Ad-22(b)(3).<sup>27</sup>

#### *C. Governance*

The Commission also finds the aspects of proposed rule change concerning amendments to ICC's governance provisions with respect to default management, use of recovery tools and clearing service termination are consistent with the Act. As described above, key decisions by the clearing house in connection with recovery or wind-down, including the use of partial tear-up and reduced gains distributions, or clearing service termination, are subject to specific governance requirements. These governance requirements include consultation with the Risk Committee, when practicable, and the requirement that certain enumerated decisions on the deployment of end-of-waterfall recovery tools, such as reduced gains distributions, partial tear-up, or clearing service termination, must be made by the Board and cannot be delegated to ICC management. In addition to the governance requirements regarding key decision-making, the proposed rule change also specifies the conditions to the invocation and continuation of reduced gains distributions. Moreover, the proposed rule change further clarifies that ICC's emergency authority does not permit overriding the limitations on Participant obligations during the cooling-off period, or permit ICC's management to invoke partial tear-up of positions without going through the required governance processes as described above. With respect to clearing service termination, as described above, ICC also proposes to establish more specific procedures, such as the timing of termination and calculation of termination prices.

Accordingly, the Commission believes that these governance changes and related clarifications provide greater specificity, transparency, fair representation of Participants, and a sound process for Participants' input with respect to ICC's default management, recovery, and wind-down, as applicable, and are reasonably designed to establish governance arrangements that are clear and transparent to fulfill the public interest and support the objectives of owners and participants, and promote the effectiveness of the clearing agency's risk management procedures, consistent with the requirements in Section 17A of the Act and Exchange Act Rule 17Ad-22(d)(8).<sup>28</sup>

The Commission notes that a commenter urged that ICC implement greater governance requirements with regard to the invocation of certain loss allocation methods. In particular, the commenter suggested that ICC be required to consult not only with its Risk Committee, but also with all Participants when "invoking tools that impact loss distributions after the exhaustion of funded and unfunded resources."<sup>29</sup> The commenter did not provide any analysis regarding whether the governance changes proposed by ICC are consistent with the applicable requirements under the Exchange Act and applicable rules and regulations thereunder. As stated above, ICC must consult, if practicable, with its Risk Committee on key decisions regarding ICC's default management, recovery, and wind-down, such as the initiation and continuation of reduced gains distributions, and partial tear-up. Moreover, the decision to invoke these end-of-waterfall measures must be made by the ICC Board, which itself consists of a majority of directors that are independent of ICC. As noted above, ICC's Risk Committee consists of a supermajority of Participant members, and it in turn has the right to name four members to the ICC Board, two of which may be Participant representatives.<sup>30</sup>

The Commission also notes that this proposed rule change has been developed over the course of several years, and throughout that time ICC has regularly consulted at length with Participants (individually and as a group) on both the overall design and drafting of this proposed rule change. In particular, the introduction of partial tear-up and reduced gains distributions as recovery tools have been discussed in detail with Participants, and have been

<sup>22</sup> See ICC Rule 808(d).

<sup>23</sup> See Rule 808(e).

<sup>24</sup> 17 CFR 240.17Ad-22(d)(11).

<sup>25</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>26</sup> 17 CFR 240.17Ad-22(b)(3).

<sup>27</sup> 17 CFR 240.17Ad-22 (b)(3).

<sup>28</sup> 17 CFR 240.17Ad-22(d)(8).

<sup>29</sup> See FIA Comment, *supra* note 4.

<sup>30</sup> See ICC Rules 503 and 508.

crafted to take into account suggestions and issues raised by Participants, including to limit the circumstances in which those tools may be used, to limit the adverse impact of such tools on netting, regulatory capital, and other matters, and to consult with Risk Committee in major decisions.<sup>31</sup> In addition, as described above, the proposed rule change clarifies that ICC's senior management would not be permitted to invoke emergency authority to initiate these recovery tools without consulting the Risk Committee, if practicable, and obtaining the Board's approval.

Based on the extensive ex ante consultation with Participants at the proposal development stage and the enhanced governance provisions surrounding ICC's invoking tools that impact loss distributions after the exhaustion of funded and unfunded resources, the Commission does not believe that the proposed rule change is inconsistent with the Act because it does not require ICC to consult with all Participants when it invokes loss distribution tools. As discussed above, the Commission finds that the governance provisions and related clarification changes as part of the proposed rule change are reasonably designed to establish governance arrangements that are clear and transparent to fulfill the public interest and support the objectives of owners and participants, and promote the effectiveness of the clearing agency's risk management procedures, consistent with the requirements in Section 17A of the Act and Exchange Act Rule 17Ad-22(d)(8).

## V. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as modified by Amendment No.

1, is consistent with the Act. Comments may be submitted by any of the following methods:

### Electronic Comments

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-ICC-2016-013 on the subject line.

### Paper Comments

Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549-1090. All submissions should refer to File Number SR-ICC-2016-013. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street NE., Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filings will also be available for inspection and copying at the principal office of ICE Clear Credit and on ICE Clear Credit's Web site at <https://www.theice.com/clear-credit/regulation>.

All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-ICC-2016-013 and should be submitted on or before February 2, 2017.

## VI. Accelerated Approval of Proposed Rule Change, as Modified by Amendment No. 1

The Commission finds good cause, pursuant to section 19(b)(2) of the Act,<sup>32</sup> to approve the proposed rule changes, as modified by Amendment No. 1, prior

to the 30th day after the publication of Amendment No. 1 in the **Federal Register**. As discussed above, Amendment No.1 clarifies various aspects of ICC's proposal to utilize reduced gains distributions, as well as its proposal to collect additional initial margin after the cap on replenishments and assessments to the guaranty fund is reached. Amendment No. 1 does not raise any novel regulatory issues, nor does it materially alter the substance of ICC's proposed rule changes.

Accordingly, on its own motion, the Commission finds good cause for approving the proposed rule changes, as modified by Amendment No. 1, on an accelerated basis, pursuant to section 19(b)(2) of the Act.

## VII. Conclusion

On the basis of the foregoing, the Commission finds that the proposal is consistent with the requirements of the Act and in particular with the requirements of Section 17A of the Act<sup>33</sup> and the rules and regulations thereunder.

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>34</sup> that the proposed rule changes (File No. SR-ICC-2016-013), as modified by Amendment No. 1, be, and hereby is, approved on an accelerated basis.<sup>35</sup>

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>36</sup>

**Eduardo A. Aleman,**  
Assistant Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

### Proposed Collection; Comment Request

*Upon Written Request, Copies Available From:* Securities and Exchange Commission, Office of FOIA Services, 100 F Street NE., Washington, DC 20549-2736

#### Extension:

Rule 8c-1; SEC File No. 270-455, OMB Control No. 3235-0514.

Notice is hereby given that pursuant to the Paperwork Reduction Act of 1995 ("PRA") (44 U.S.C. 3501 *et seq.*), the Securities and Exchange Commission ("Commission") is soliciting comments

<sup>31</sup> See Notice, 81 FR 83914-15. The Commission also notes that in addition to consulting Participants on the proposed rule change and the governance surrounding the use of recovery tools, ICC also consulted with the customers of Participants. In particular, ICC discussed the proposed rule change individually with members of its buy-side advisory committee, which consists of customers of Participants. ICC also considered the views of industry groups representing customers of Participants, both through discussions with members of such groups and through the public statements and positions of such groups. ICC has taken these views into account and incorporated them into the proposed rule change, including limiting the use of reduced gains distributions to scenarios where all other financial resources of the clearing house have been exhausted, and moving the priority of ICC's contributions in the waterfall such that they are used prior to the guaranty fund contributions of non-defaulting Participants. See *id.* at 83915.

<sup>32</sup> 15 U.S.C. 78s(b)(2).

<sup>33</sup> 15 U.S.C. 78q-1.

<sup>34</sup> 15 U.S.C. 78s(b)(2).

<sup>35</sup> In approving the proposed rule changes, the Commission considered the proposal's impact on efficiency, competition and capital formation. 15 U.S.C. 78s(f).

<sup>36</sup> 17 CFR 200.30-3(a)(12).