



February 26, 2009

Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549

Attention: Elizabeth Murphy  
Secretary

Re: Request for Exemption from Certain Provisions of the U.S. Securities Exchange Act of 1934 and the Securities Act of 1933 with Respect to Cleared Credit Default Swaps

Ladies and Gentlemen:

We are writing on behalf of IntercontinentalExchange, Inc. ("ICE"), a corporation organized under the laws of the State of Delaware, and The Clearing Corporation, a corporation organized under the laws of the State of Delaware ("TCC"), to request that the U.S. Securities and Exchange Commission (the "Commission" or "SEC") grant, under the circumstances and subject to the conditions and representations set forth in this letter, certain exemptive relief to ICE US Trust LLC ("ICE Trust"), a wholly-owned subsidiary of ICE US Holding Company GP LLC (formerly named ICE US Trust Holding Company LLC), a Delaware limited liability company ("Holdco GP LLC"), participants in ICE Trust ("ICE Trust Participants"), certain entities affiliated with ICE Trust Participants<sup>1</sup> ("Affiliates" which, together with ICE Trust Participants, are referred to as "Participants") and inter-dealer brokers ("IDBs") in connection with credit default swaps ("CDS") entered into by such ICE Trust Participants (or their Affiliates) with other ICE Trust Participants and submitted to ICE Trust for clearance and

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<sup>1</sup> For purposes of this request, an affiliate means an entity that directly, or indirectly through one or more intermediaries controls or is controlled by, or in under common control with an ICE Trust Participant.

settlement as described herein. Specifically, ICE, ICE Trust and TCC request that the Commission issue three exemptive orders or rules:<sup>2</sup>

(i) An order pursuant to Section 17A(b)(1) of the U.S. Securities Exchange Act of 1934, as amended, (the “Exchange Act”), for the avoidance of uncertainty, exempting ICE Trust from any requirement that it register with the Commission as a clearing agency pursuant to Section 17A of the Exchange Act, to the extent such provisions would otherwise be applicable to ICE Trust, on the terms and subject to the conditions described in Section IV.A of this request;<sup>3</sup>

(ii) An order pursuant to Section 36(a)(1) of the Exchange Act, for the avoidance of uncertainty, exempting ICE Trust and its Participants from any requirement that they comply with provisions of the Exchange Act governing securities transactions, to the extent such provisions would otherwise be applicable to ICE Trust and its Participants, in connection with the offer, execution, termination, clearance, settlement, performance and related activities contemplated by the ICE Trust Rules and this request involving CDS transactions submitted (or executed on terms providing for submission) to ICE Trust for clearance and settlement, subject to the condition that ICE Trust and its Participants comply with, and be subject to, the provisions of the Exchange Act applicable to “security-based swap agreements,” as defined in section 206B of the Gramm-Leach-Bliley Act of 1999, as amended (“GLBA”); and

(iii) An order pursuant to Section 36(a)(1) of the Exchange Act, for the avoidance of uncertainty, exempting any IDB from any requirement that it comply with provisions of the Exchange Act governing securities transactions, to the extent such provisions would otherwise be applicable to such IDB, in connection with the effectuation by such IDB of CDSs submitted to ICE Trust for clearance and settlement, on the terms and subject to the conditions described in Section IV.C of this request.

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<sup>2</sup> On January 14, the Commission adopted interim temporary final rules that define and exempt “eligible credit default swaps” from all provisions of the Securities Act of 1933 (the “Securities Act”) (other than the anti-fraud provisions of section 17(a)) as well as from the registration provisions of the Exchange Act and the provisions of the Trust Indenture Act of 1939, as amended, provided certain conditions are met. These rules also define “qualified purchaser” for purposes of the covered securities provisions of Securities Act section 18. These rules became effective January 22, 2009. See Release Nos. 33-8999; 34-59246; 39-2549, “Temporary Exemptions for Eligible Credit Default Swaps to Facilitate Operation of Central Counterparties to Clear and Settle Credit Default Swaps.” ICE Trust intends to rely on these interim temporary final rules.

<sup>3</sup> As part of this request, the applicants also seek relief from the provisions of Exchange Act Section 17A(b)(2) requiring the filing of a Form CA-1 in light of the revised Certificate of Merit dated November 7, 2008 submitted to the New York State Banking Department (“NYSBD”) and other exhibits provided in a separate supplemental submission to the Commission.

Except as provided in the conditions for exemptive relief described in Sections IV.A and IV.C, this request is without prejudice to, and is not intended to limit, ICE Trust's, the ICE Trust Participants' and the other specified applicants' eligibility for or reliance on any other statutory or regulatory basis for relief from the provisions of the Exchange Act or Securities Act (together with the Exchange Act, the "Acts") in connection with the activities contemplated by this request.

This request consists of five Sections. Section I sets out certain background information with respect to the CDS market. Section II provides a brief description of ICE Trust and its proposed clearing activities. Section III describes certain considerations with respect to the regulatory status of CDS. Section IV describes regulatory oversight of ICE Trust and the basis for the exemptive relief requested. Section V concludes the request.

We have included with this request the public exhibits listed in the Exhibit Index hereto

#### I. Credit Default Swaps

A credit default swap or CDS is a bilateral executory derivative instrument. CDS can be used to hedge or transfer to another party the credit risk of an obligor or to gain exposure to the credit risk of an obligor. Under a typical CDS, the parties specify the obligor (called the "reference entity") with respect to which credit protection is sought, the credit-related events, such as a payment default or bankruptcy (called "credit events"), that trigger settlement obligations, the debt obligations of the reference entity (called "reference obligations") whose nonpayment constitutes a credit event, and the debt obligations (called "deliverable obligations") that may be delivered upon the occurrence of a credit event or, in the case of cash settlement, the obligations (typically the reference obligations) whose value is used to determine the amount of any cash settlement payment under the CDS.

Very generally, the party seeking credit protection (the "protection buyer") under a CDS makes periodic fixed payments to the party providing credit protection (the "protection seller"). The protection seller agrees, in exchange for such periodic fixed payments, to purchase from the protection buyer, at par value (or for some other designated value), an agreed principal amount (the "notional amount") of deliverable obligations in the event that the reference entity experiences one or more specified credit events or to effect a cash settlement by payment of the difference between the par (or other designated) value of a reference obligation and the reference obligation's market value following the credit event.

The reference entity can be a company, a governmental entity or any other borrower. The deliverable or reference obligations can consist of a specific obligation of the reference entity, a category of obligations, or all repayment obligations of the reference entity. There is no requirement that either party to a CDS hold any obligations of the reference entity.

A CDS thus enables a lender, for example, to purchase protection against a borrower's payment default. It similarly enables the protection seller to receive income in exchange for assuming exposure to the borrower's credit. In addition to mitigating credit risk for a lender, a CDS also enables a market participant to take "long" or "short" positions on the credit quality of an obligor without transacting directly in the debt obligations of the obligor.

CDS can be written on a single reference entity ("single name CDS") or CDS can be written with respect to groups or indices of reference entities ("index CDS"). Index CDS allow market participants to more efficiently manage or assume exposure to the creditworthiness of specific sectors of the economy.

CDS are bilaterally negotiated transactions documented under the International Swaps and Derivatives Association's ("ISDA") master agreement ("Master Agreement") and a schedule ("Schedule") that is used to supplement and/or modify the Master Agreement based on each party's own assessment of its contractual requirements. In addition, the parties typically enter into a credit support annex ("CSA") that, if used, establishes a framework between the two parties for the collateralization of credit exposures (by one or both parties), based on the counterparty risk presented by each party and its positions. The specific terms of an individual CDS transaction are documented in a confirmation ("Confirmation") that supplements and incorporates the Master Agreement, Schedule and CSA in place between the parties. As market participants naturally seek to maximize market depth and liquidity, CDS trading has coalesced around market conventions (such as common expiration dates, common credit events, etc.) that enhance liquidity. Despite these developments, market participants remain free to and do negotiate customized transaction terms. Additionally, the ISDA Schedule and CSA tend to be extensively negotiated on a bilateral basis.

Even though CDS are a relatively recent financial innovation, they have quickly become an extremely important and widely used tool for the mitigation and transfer of credit risk. Prior to the advent of the over-the-counter ("OTC") CDS market, no tradable financial instrument existed that would enable a company exposed to a third party's default risk to manage that credit risk efficiently and in a liquid market. Created in response to the need for such an instrument, CDS have provided enormous benefits both to financial institutions and to borrowers. They enable financial institutions to hedge the credit risks inherent in the corporate financings that are necessary for economic growth. This enhances the stability of financial institutions and reduces the cost of funds for borrowers. It also makes additional credit capacity available, enabling financial institutions to expand the credit facilities they are able to offer to their commercial and investment banking clients. It is therefore not surprising that CDS have seen significant growth in recent years.

The Bank for International Settlements (“BIS”) has estimated that, as of December 2007, the outstanding notional amount of CDS was just under \$58 trillion.<sup>4</sup> The outstanding notional amount of CDS has recently been substantially reduced through a series of voluntary netting initiatives and is currently estimated to be less than \$29 trillion.<sup>5</sup> A majority of the market is comprised of bilateral OTC transactions between dealers, which includes approximately 15 to 20 global commercial and investment banks, and the largest share of the notional amount within that sector is comprised of index CDS.<sup>6</sup>

The current CDS market faces a number of credit and related operational challenges and inefficiencies:

1. Counterparty Risk. Counterparty risk is a primary concern for CDS market participants. As bilateral transactions, CDS expose each party to the risk of the other party’s non-performance. This is of particular concern to the protection buyer under a CDS, because its ability to successfully protect itself against the failure or default of a reference entity depends on the protection seller’s ability to perform its obligations under the CDS.
2. Redundant Gross Notional Exposures. As professional intermediaries supply liquidity to the CDS market, they simultaneously accumulate large notional exposures. Many of these exposures are offsetting but are executed opposite different counterparties. Professional intermediaries may also have large offsetting exposures with each other. These

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<sup>4</sup> Report entitled “Credit Default Swap Market Notional amounts outstanding at end of December 2007” published by the Bank for International Settlement, available at <http://www.bis.org/statistics/otcder/dt21.pdf>.

It is important to note that the outstanding notional amount of CDS published by the BIS does not accurately reflect the actual levels of market and credit risk exposures in the CDS market. To calculate such exposures one would need to consider the following: (1) net exposure of the participants in the market, after taking into account offsetting positions; (2) the probability that the underlying reference entities will default; (3) the probability that any party to a CDS will default in its obligations under the applicable CDS; (4) the amount of collateral held by participants in the market; and (5) the probable recovery amounts that the participants will collect upon the occurrence of probable defaults. Due to the bilateral nature of CDS transactions and the lack of any central counterparty or systematic information aggregator, it is very difficult to determine actual risk exposures in this market.

<sup>5</sup> See [http://www.dtcc.com/products/derivserv/data\\_table\\_i.php](http://www.dtcc.com/products/derivserv/data_table_i.php), [http://www.markit.com/information/news/press\\_releases/2008/october/16.html](http://www.markit.com/information/news/press_releases/2008/october/16.html), [http://www.markit.com/information/news/press\\_releases/2008/october/31.html](http://www.markit.com/information/news/press_releases/2008/october/31.html), and [http://www.markit.com/information/news/press\\_releases/2008/november/24.html](http://www.markit.com/information/news/press_releases/2008/november/24.html).

<sup>6</sup> Testimony of Patrick M. Parkinson, Deputy Director, Division of Research and Statistics of the Federal Reserve Board, before the Subcommittee on Securities, Insurance and Investment of the U.S. Senate Committee on Banking, Housing and Urban Affairs, July 8, 2008 (the “Parkinson Testimony”), p. 1. This testimony is available at <http://www.federalreserve.gov/newsevents/testimony/parkinson20080709a.htm>.

offsetting gross notional CDS exposures give rise to potentially redundant counterparty credit exposures that remain on market participants' books so long as the offsetting CDS exposures remain outstanding. The large population of redundant, offsetting transactions also gives rise to additional operational inefficiencies for the market as noted below.

3. CDS Transaction Processing Backlog. The CDS market's rapid growth has seen widespread use of these products by large numbers and categories of market participants. ISDA has estimated that from 2004 to 2006 the notional size of the CDS market grew fivefold.<sup>7</sup> Because CDS are individually negotiated and are generally not executed through exchanges or other electronic matching engines, the processing of confirmations evidencing CDS transactions is generally handled individually by market participants, each of which has different levels of operational infrastructure and capacity to process CDS transactions. Not surprisingly, this has resulted in processing backlogs in the confirmation of CDS transactions.<sup>8</sup>

4. Monitoring and Managing CDS Transactions. As noted above, the volume and bilateral character of CDS transactions requires that firms have significant operational resources. Large outstanding CDS trade populations increase the operational resources necessary to monitor and administer these positions. This operational burden can become particularly acute in times of market stress, such as in circumstances where a major counterparty defaults, or in the case of a credit event affecting a borrower that is a reference entity under large numbers of CDS.

In order to help mitigate the counterparty credit exposures and related operational inefficiencies associated with the current CDS market and large redundant trade populations, ICE Trust proposes to act as a central counterparty to qualifying CDS market participants in connection with eligible CDS transactions submitted to it for clearing, as described more fully in Section II below.

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<sup>7</sup> "Fed Says Banks Meet Target on Derivatives Backlog." Bloomberg, February 16, 2006, available at <http://www.bloomberg.com/apps/news?pid=10000006&sid=aO.Ek0E2iqpl&refer=home>.

<sup>8</sup> In order to address this issue, major market participants have increasingly used the trade comparison and confirmation services offered by DTCC's Deriv/SERV service described in Section II below. The use of this service and other measures has significantly reduced confirmation backlogs for many of the largest market participants.

## II. Description of ICE Trust's Proposed Clearing Activities

### A. Overview

#### 1. Background

ICE, in conjunction with TCC, is planning to launch a new global central clearing platform for CDS. With the approval by the NYSBD of the ICE application on December 4, 2008, ICE Trust has been established as a limited purpose limited liability trust company, which will provide the clearance and settlement platform and services. Based on the anticipated closing of the acquisition described below, current scheduling and consultation with regulators, ICE intends to launch ICE Trust's clearing services as promptly as possible following receipt of all necessary regulatory approvals and the relief requested herein.

#### 2. Information about the Acquisition of TCC by ICE

On October 29, 2008, ICE announced its plan to acquire TCC. ICE and TCC entered into a term sheet dated October 29, 2008 with respect to such acquisition. The parties have negotiated and agreed upon definitive transaction documents.

The acquisition of TCC remains subject to the satisfaction of certain conditions, including receipt of all necessary approvals from governmental authorities for clearing CDS and for the consummation of the transaction. ICE anticipates closing the transaction upon the termination or expiration of the Hart-Scott-Rodino ("HSR") waiting period. The parties filed under HSR on December 23, 2008 and requested early termination.

The acquisition is being structured such that Holdco GP LLC will contribute its sole membership interest in ICE Trust to ICE US Holding Company L.P., a Cayman Islands exempted limited partnership ("ICE Holding LP") so that ICE Holding LP will be the sole member of ICE Trust and Holdco GP LLC will be the general partner of, and manage, ICE Holding LP. ICE Holding LP will also be the sole shareholder of TCC. ICE is the sole member of Holdco GP LLC and has sole authority to appoint its board of managers.

There will be two classes of LP interests in ICE Holding LP: (a) Class A LP interests, which will be held by ICE and Holdco GP LLC, and (b) Class B LP interests, which will be held by the current shareholders of TCC. Any profits received by ICE Holding LP from ICE Trust will be distributed 50 percent to the Class A LP interest holders and 50 percent to the Class B LP interest holders. The voting rights of the membership interests will be vested solely in the Class A LP interest holders.

3. Information about ICE

ICE, organized in May 2000 under the laws of the State of Delaware, is a publicly traded company listed on the New York Stock Exchange (“NYSE”) that trades under the ticker symbol “ICE”. ICE, directly and through its wholly-owned subsidiaries, operates global regulated futures exchanges and OTC-markets for commodities and derivative products and currently operates two central party clearing houses in North America and, in November 2008, commenced operating a central party clearing house in Europe. ICE operates its OTC energy markets through its globally distributed electronic platform and ICE owns 100 percent of:

- ICE Futures Europe, which operates as a United Kingdom Recognized Investment Exchange for the purposes of price discovery, trading and risk management within the energy commodity futures and options markets;
- ICE Futures U.S., Inc., which operates as a United States Designated Contract Market for the purpose of price discovery, trading and risk management within the soft commodity, index and currency futures and options markets;
- ICE Futures Canada, Inc., which operates as a Canadian Commodity Futures Exchange for the purpose of price discovery, trading and risk management within the agricultural futures and options markets;
- Creditex Group Inc., which operates in the OTC CDS markets;
- ICE Clear U.S. which performs the clearing and settlement of every futures and options contract traded through ICE Futures U.S., Inc.;
- ICE Clear Canada which performs the clearing and settlement of every futures and options contract traded through ICE Futures Canada, Inc.; and
- ICE Clear Europe which, since November 8, 2008, performs the clearing and settlement of every futures and options contract trading through ICE Futures Europe and for all of ICE’s cleared OTC energy products.

ICE does not risk its own capital by extending credit to market participants in any trading activities. ICE does, however, take matched principal positions in a small portion of Creditex’s business but only as an intermediary between two counterparties. ICE’s business generally serves as a marketplace, bringing together buyers and sellers of derivatives, physical commodities and financial contracts and allowing its participants to optimize their trading, risk management and hedging operations.



4. Information about TCC

TCC, a closely held corporation organized under the laws of the State of Delaware, is owned by eleven major financial institutions, three leading OTC derivatives inter-dealer brokers, an international exchange and a leading OTC services provider.<sup>9</sup> TCC is a registered derivatives clearing organization, regulated by the Commodity Futures Trading Commission. TCC has cleared futures contracts as an independent clearinghouse since 1925. Currently, TCC has approximately 50 participants and provides derivatives clearing services for multiple exchanges and marketplaces, including the Chicago Climate Futures Exchange, the United States Futures Exchange<sup>10</sup>, the Eurex Global Clearing Link, OTC Benchmark Treasury Futures, and the Financial and Energy Exchange (FEX Australia).<sup>11</sup> As a registered derivatives clearing organization, TCC is currently regulated by the Commodity Futures Trading Commission. Throughout its history, TCC has continuously evolved to meet the evolving needs of the derivatives market. It has been an industry innovator while continuing its role as central counterparty. At least initially, it is envisaged that ICE Trust will receive processing and operational support from TCC, ICE and other wholly-owned subsidiaries of ICE.

5. Information about ICE Trust

ICE Trust, effective December 4, 2008, is organized as a New York State chartered limited liability trust company and will become a member of the Federal Reserve System. ICE Trust is subject to direct supervision and examination by the NYSBD and, due to its expected membership in the Federal Reserve System, will be subject to direct supervision and examination by the Board of Governors of the Federal Reserve System (“Federal Reserve”), specifically the Federal Reserve Bank of New York (“FRBNY”).

Initially, ICE Trust’s business will be limited to the provision of clearing services for the OTC CDS market. During this initial phase, ICE Trust will act as a central counterparty for ICE Trust Participants (in each case, acting as principal for its own account or the account of an Affiliate<sup>12</sup>) by assuming, through novation, the obligations of all eligible CDS transactions

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<sup>9</sup> The current shareholders of TCC include: Bank of America Strategic Investments Corporation, Barclays Bank PLC, Citigroup Global Markets Inc., Credit Suisse First Boston Next Fund, Inc., Creditex Group Inc., Deutsche Bank Securities Inc., GFI.net Inc., Goldman, Sachs & Co., ICAP Securities No. 2 B.V., LabMorgan Corporation, Markit Group Limited, Merrill Lynch, Pierce, Fenner & Smith Incorporated, MF Global Inc., Morgan Stanley & Co. Incorporated, UBS Americas Inc., and U.S. Exchange Holdings, Inc.

<sup>10</sup> The agreement with the United States Futures Exchange is in the process of being terminated.

<sup>11</sup> FEX Australia expects to launch as a live exchange in early 2009.

<sup>12</sup> In cases in which an ICE Trust Participant acts for the account of an Affiliate, it will be for the proprietary account of such Affiliate as principal and not as agent for any other person.

accepted by it for clearing and collecting margin and other credit support from the ICE Trust Participants to collateralize their obligations to ICE Trust.

We anticipate that when ICE Trust's CDS clearing service launches, it will first address the reduction of the existing population of inter-Participant index CDS. On a regular basis, ICE Trust will process and clear outstanding inventories of qualifying CDS. This is expected to significantly reduce the outstanding notional amount of inter-dealer index CDS. ICE Trust will subsequently begin its "live" clearing service, and ICE Trust Participants (in each case, acting as principal for its own account or the account of an Affiliate) will be able to indicate at execution of a transaction that the transaction is to be submitted to ICE Trust for clearing. In the initial phase, ICE Trust's CDS clearing services will be limited to transactions for the proprietary accounts of ICE Trust Participants (in each case, acting as principal for its own account or the account of an Affiliate).

The first products ICE Trust expects to clear include certain untranched CDX North American Investment Grade, High Yield and Crossover indices. Thereafter ICE Trust anticipates that it will expand the range of CDS contracts eligible for clearing, including iTraxx indices, single name CDS, and additional CDX indices (including tranches).

#### B. Participants in ICE Trust

Participation in ICE Trust will be open to all qualified applicants, each of whom will clear transactions solely as principal for its own (or an Affiliate's) account and not on behalf of other persons. In order to qualify as an ICE Trust Participant, an applicant will be required to satisfy ICE Trust's participant criteria at the time that the applicant applies to ICE Trust and on an ongoing basis thereafter. These criteria are specified in ICE Trust Rule 201. As of the date of this letter, these requirements include the following:

- regulation for capital adequacy by a federal or foreign financial regulator or status as an affiliate of an entity that is subject to regulation (as a result of which such Participant would be subject to consolidated holding company group supervision) by such financial regulator;
- the ICE Trust Participant or, at ICE Trust's discretion, the parent entity of the ICE Trust Participant, if the parent entity is providing an unconditional guaranty of the ICE Trust Participant's obligations to ICE Trust, must have \$5 billion in tangible net worth (computed in accordance with the Federal Reserve's definition of "Tier 1 capital" as set forth in Federal Reserve Regulation Y Part 225 Appendix A);
- the ICE Trust Participant or, at ICE Trust's discretion, the parent entity of the ICE Trust Participant, if the parent entity is providing an unlimited guaranty of the ICE Trust

Participant's obligations to ICE Trust, must (x) at the time of admission, have a minimum long-term debt rating of "A" from Standard & Poor's (and its equivalent from other nationally recognized rating agencies) and (y) at any time after admission, maintain a minimum long-term debt rating of at least "BBB" from Standard & Poor's (and its equivalent from other nationally recognized rating agencies); provided that, if the ICE Trust Participant, or its parent entity, as the case may be, does not satisfy the foregoing ratings requirement, it demonstrates to ICE Trust that it otherwise satisfies, in the sole discretion of ICE Trust, other stringent credit criteria established by ICE Trust;

- demonstrated operational competence in CDS;
- demonstrated risk management competence; and
- ongoing membership in CDS industry organizations, such as the International Swaps and Derivatives Association and the Deriv/SERV service of The Depository Trust & Clearing Corporation ("DTCC").

These requirements are consistent with international standards for central counterparties as articulated in the Recommendations for Central Counterparties, Bank for International Settlements, Committee on Payment and Settlement Systems and Technical Committee of the International Organization of Securities Commissions, November 2004 (the "BIS IOSCO CCP Recommendations").<sup>13</sup> The BIS IOSCO CCP Recommendations require "participants to have sufficient financial resources and robust operational capacity to meet obligations arising from

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<sup>13</sup> BIS IOSCO CCP Recommendations, p. 16-17.

The BIS IOSCO CCP Recommendations reflect the views of central banks, securities regulators and other financial regulators from the Group of Ten and other countries. In his July 9, 2008 testimony before the Subcommittee on Securities, Insurance, and Investment of the Senate Committee on Banking, Housing, and Urban Affairs, the Commission's chief economist, James A. Overdahl, described the significance of the BIS IOSCO CCP Recommendations and the Commission's role in drafting it:

"In 2001 and 2004, the SEC was at the forefront of establishing higher standards to reflect the complexities of an ever increasing global and interconnected securities market. The SEC did this by helping to draft the Committee on Payment and Settlement Systems and International Organization of Securities Commissions report called the Recommendations for Securities Settlement Systems and Recommendations for Central Counterparties. These reports establish today's standards on how a clearance and settlement system must operate." Senate testimony available at <http://www.sec.gov/news/testimony/2008/ts070908jao.htm>.

The Federal Reserve has also endorsed the BIS IOSCO Recommendations, and has stated that it will apply those standards to any bank that is organized to serve as a CCP for credit derivatives (such as ICE Trust). Parkinson Testimony, p. 5.

participation” in a clearing organization.<sup>14</sup> It is anticipated that initially the ICE Trust Participants will be the following ten major CDS dealers: Bank of America, Barclays,<sup>15</sup> Citibank, Credit Suisse, Deutsche Bank, Goldman Sachs, JPMorgan Chase, Merrill Lynch, Morgan Stanley, and UBS.

### C. Clearing of CDS

ICE Trust’s structure and operations will be subject to comprehensive federal and New York State supervision and review as well as industry consultation, and further development of its structure and operations will be subject to approval by its bank regulators. We respectfully request that the exemptive relief sought herein apply on an ongoing basis to ICE Trust and its Participants as the ICE Trust Rules and operations evolve subject to NYSBD and Federal Reserve regulatory oversight, and subject to compliance with such conditions as the Commission may impose in connection with any order granted by it in response to this request.

#### 1. ICE Trust as Central Counterparty

In order for ICE Trust to act as central counterparty and clear CDS, it must first receive accurate and reliable information regarding the transactions that are submitted for clearing. Additionally, as a clearinghouse, ICE Trust’s primary role will be to reduce the credit risk associated with cleared CDS. Accordingly, ICE Trust’s trade submission process is designed to ensure that it maintains a matched book of offsetting CDS contracts, a prerequisite for any central counterparty.

Although CDS are currently bilaterally negotiated and executed, major market participants frequently use DTCC’s Deriv/SERV comparison and confirmation service when documenting their CDS.<sup>16</sup> This service creates accurate electronic records of transaction terms

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<sup>14</sup> BIS IOSCO CCP Recommendations, p. 4.

ICE expects that all of TCC’s current shareholder banks and dealers (each of whom currently meets these requirements) will participate as clearing Participants of ICE Trust. The inter-dealer market represents the most significant portion of the outstanding notional amount of the CDS market, and TCC’s shareholder banks and dealers account for the majority of this volume. Accordingly, ICE Trust should be in a position from its inception to clear a significant portion of the CDS market and to reduce significantly associated counterparty credit and operational risks.

<sup>15</sup> It is currently anticipated that Barclays will be ready operationally in February to clear CDS with ICE Trust and, depending on the launch date of the ICE Trust clearing services, will become an ICE Trust Participant shortly after launch.

<sup>16</sup> For ease of reference herein, DTCC is referred to as the service provider of Deriv/SERV confirmation and matching services. However, on July 21, 2008, DTCC and Markit entered into a joint venture to provide OTC confirmation and matching services. Accordingly, Deriv/SERV may be administered by an entity

and counterparties. As part of this service, market participants separately submit the terms of a CDS to Deriv/SERV in electronic form. Paired submissions are compared to verify that their terms match in all required respects. If a match is confirmed, the parties receive an electronic confirmation of the submitted transaction. All submitted transactions are recorded in the Deriv/SERV Trade Information Warehouse, which serves as the primary registry for submitted transactions.<sup>17</sup>

ICE Trust will leverage the Deriv/SERV infrastructure in operating its CDS clearing service. Initially, all trades submitted by Participants for clearing through ICE Trust will be recorded in the Deriv/SERV Trade Information Warehouse. ICE Trust will, initially on a weekly basis, obtain from DTCC matched trades that have been recorded in the Deriv/SERV Trade Information Warehouse as having been submitted for clearing through ICE Trust. Within two months of launch, ICE Trust intends to obtain matched trades from DTCC on a daily basis. ICE Trust expects that, in time, the matching service provided by Deriv/SERV or other parties will automatically forward, on a real time basis, to ICE Trust qualifying matched CDS contracts that both parties have elected to submit for clearing.

Participants may use the facilities of an inter-dealer broker to execute CDS, for example, to access liquidity more rapidly or to maintain pre-execution anonymity, and submit such transactions for clearance and settlement to ICE Trust.<sup>18</sup> These inter-dealer brokers may variously be unregistered with the Commission, may be registered as broker-dealers, or may be registered as broker-dealers and operating subject to Regulation ATS. To our knowledge, none of these inter-dealer brokers discipline their subscribers other than by exclusion from trading. Additionally, to our knowledge, these inter-dealer brokers, although they are compensated for matching and effecting CDS transactions, do not handle the funds or property of their CDS participants. The inter-dealer brokers similarly do not assume market positions in connection with their intermediation of CDS transactions.

As described below, once a matched CDS contract has been forwarded to, or obtained by, ICE Trust, and has been accepted for clearing by it, ICE Trust will clear the CDS contract by becoming the central counterparty to each party to the trade through novation. Deriv/SERV's current infrastructure will help to ensure that ICE Trust maintains a matched book of offsetting

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other than DTCC. In that event, ICE Trust will enter into an appropriate agreement or assignment with the successor entity administering the Deriv/SERV confirmation and matching services.

<sup>17</sup> Deriv/SERV has recently begun to manage payment flows, settlements, and adjustments to contract terms through the CDS lifecycle.

<sup>18</sup> Inter-dealer brokers currently active in the CDS market include Garban, Creditex, GFI, Tullet Prebon, Markit and ICAP.

CDS contracts. Maintaining a matched offsetting book is essential to managing the credit risk associated with CDS submitted to ICE Trust for clearing.

Under the ICE Trust Rules, each bilateral CDS contract between two ICE Trust Participants that is submitted, and accepted by ICE Trust, for clearing will be “novated.” As part of this process, each bilateral CDS contract submitted to ICE Trust will be replaced by two superseding CDS contracts between each of the original parties to the submitted transaction and ICE Trust. Under these new contracts, ICE Trust will act as protection buyer to the original protection seller and as protection seller to the original protection buyer. As central counterparty to each novated CDS contract, ICE Trust will be able to net offsetting positions on a multilateral basis, even though ICE Trust will have different counterparties with respect to the novated CDS contracts that are being netted.

As part of the novation process, the terms and conditions governing the CDS bilaterally negotiated by the submitting counterparties will be superseded by the relevant provisions of the ICE Trust Rules applicable to the relevant CDS transaction. This step is necessary in order to eliminate any documentation basis risk, and consequent financial risk, to ICE Trust (and, indirectly, to Participants) that could arise if, as a result of multilateral netting, the documentation terms governing opposite sides of offsetting CDS positions to which ICE Trust is central counterparty are not consistent.

Multilateral netting will significantly reduce the outstanding notional amount of each Participant’s CDS portfolio. By eliminating all offsetting positions, ICE Trust will significantly reduce not only the gross outstanding notional amount of cleared CDS, but also the counterparty credit risk and operational risks associated with the redundant positions that are extinguished through the multilateral netting process.

As a central counterparty, ICE Trust will also offer its ICE Trust Participants significant operational efficiencies. Because ICE Trust acts as the central counterparty to all cleared CDS of an ICE Trust Participant, that Participant’s positions will be netted down to a single exposure to ICE Trust. ICE Trust’s ability to provide a single net exposure figure to each ICE Trust Participant will (i) provide each ICE Trust Participant with a clear snapshot of its aggregate cleared CDS positions and related position risk and (ii) greatly simplify the ICE Trust Participant’s cash flow and related operational responsibilities, since each such Participant faces only a single counterparty (ICE Trust) and payments due on different CDS contracts can be netted to a single daily payment obligation or entitlement. ICE Trust anticipates that these operational and credit risk reduction benefits will provide a strong incentive for the ICE Trust Participants to clear their eligible CDS transactions through ICE Trust. Finally, by leveraging Deriv/SERV’s matched trade submission platform, ICE Trust’s clearing system will help to further reduce processing backlogs with respect to the CDS cleared through ICE Trust.

## 2. Deriv/SERV Trade Information Warehouse

ICE Trust will maintain complete and accurate information for each cleared CDS that remains outstanding on its books. In addition to maintaining its own information, novated position data on each cleared CDS will be recorded in Deriv/SERV's Trade Information Warehouse, which will maintain a duplicate registry of all open CDS positions that have been accepted for clearance by ICE Trust. Deriv/SERV's Coupon Payment Facility will then be available to Participants to administer the calculation and transfer of periodic payments owed by protection buyers to protection sellers under outstanding ICE Trust-cleared CDS contracts.

### D. Credit Support Framework

In addition to reducing the outstanding notional amount of ICE Trust-cleared CDS, ICE Trust will further mitigate counterparty risk to ICE Trust, the ICE Trust Participants and the CDS market generally through its margin, guaranty fund and credit support framework, as set forth in the ICE Trust Rules.

As the central counterparty to each of the ICE Trust Participants, ICE Trust will have exposure to the risk of defaults by ICE Trust Participants. To address this counterparty credit risk, ICE Trust (1) will require the ICE Trust Participants to provide credit support for their obligations under cleared CDS transactions and (2) has established rules that "mutualize" (as described below) the risk of an ICE Trust Participant default across all ICE Trust Participants. ICE Trust's risk management infrastructure and related risk metrics have been structured specifically for the CDS products that ICE Trust clears. Each ICE Trust Participant's credit support obligations will be governed by a uniform credit support framework and applicable ICE Trust Rules.

#### 1. Credit Support Requirements

ICE Trust will maintain strict, objectively determined, risk-based margin and guaranty fund requirements. As described in Section IV, these requirements will be subject to extensive and ongoing regulation and oversight by the Federal Reserve and the NYSBD. These requirements will also be consistent with clearing industry practice, Basel II capital adequacy standards and international standards established for central counterparties as articulated in the BIS IOSCO CCP Recommendations. The amount of margin and guaranty fund contribution required of each ICE Trust Participant will be continuously adjusted to reflect the size and profile of, and risk associated with, the ICE Trust Participant's cleared CDS transactions (and related market factors).

Each ICE Trust Participant's margin requirement will consist of two components: (1) initial margin, reflecting a risk-based calculation of potential loss on outstanding CDS positions

in the event of a significant adverse market movement, and (2) mark-to-market margin, based upon an end-of-day mark-to-market of outstanding positions. Acceptable margin will initially include only cash in specified currencies and G-7 government debt for initial margin and only cash for mark-to-market margin. ICE Trust Participants will be required to cover any end-of-day margin deficit with U.S. dollars by the following morning, and ICE Trust will have the discretion to require and collect additional margin, both at the end of the day and intraday, as it deems necessary.<sup>19</sup>

ICE Trust will also maintain a guaranty fund (the “Guaranty Fund”) to cover losses arising from an ICE Trust Participant’s default on cleared CDS transactions that exceed the amount of margin held by ICE Trust from the defaulting ICE Trust Participant. Each ICE Trust Participant will be required to contribute a minimum of \$20 million to the Guaranty Fund initially when it becomes an ICE Trust Participant and on an ongoing basis, additional amounts based on its actual and anticipated CDS position exposures. The adequacy of the Guaranty Fund will be monitored daily and the need for additional contributions will initially be determined on at least a monthly basis, based on the size of ICE Trust Participant exposures within the ICE Trust clearing system. As a result, the Guaranty Fund will grow in proportion to the position risk associated with the aggregate volume of CDS cleared by ICE Trust.

In order to calculate the initial margin and mark-to-market margin requirements, as well as the appropriate Guaranty Fund contribution for an ICE Trust Participant, ICE Trust has developed a sophisticated and robust set of risk metrics to measure and determine these amounts. In each case, the amount of margin to be posted or contribution to be made will be calculated separately for each type of CDS cleared by an ICE Trust Participant, subject to applicable risk offsets recognized under ICE Trust’s policies and procedures. Initial margin will be calculated in accordance with the ICE Trust policies and procedures and will be based on (a) the largest probable loss likely to be sustained by the ICE Trust Participant over a specified time period due to adverse movements in credit spreads, (b) the degree to which the ICE Trust Participant’s long and short positions exhibit offsetting risk characteristics and (c) the ICE Trust Participant’s position concentration relative to the size of the market for the relevant CDS. Mark-to-market margin will be calculated daily as the replacement (or mark-to-market) value of an ICE Trust Participant’s outstanding positions based on end-of-day mark-to-market prices. Mark-to-market margin will be calculated separately for each currency in which an ICE Trust Participant has open positions.

The aggregate amount of the Guaranty Fund will be calculated using stress test scenarios that rely on a combination of quantitative and qualitative considerations to calculate the

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<sup>19</sup> An ICE Trust Participant will be permitted to withdraw mark-to-market margin amounts credited to its account to the extent not required to satisfy its initial margin requirement.



magnitude of portfolio losses. The size of the Guaranty Fund will be set at the sum of the maximum scenario stress test uncollateralized losses for (a) the ICE Trust Participant with the largest long credit protection profile (*i.e.*, the ICE Trust Participant that has bought the most credit protection) and (b) the two ICE Trust Participants with the largest short protection profiles (*i.e.*, the two ICE Trust Participants that have sold the most credit protection).

## 2. Mutualization

Mutualization is designed to provide additional protection to ICE Trust from losses arising from an ICE Trust Participant's default by making other Participants' contributions to the Guaranty Fund available to cover the defaulting ICE Trust Participant's losses.

In the event of an ICE Trust Participant's default, ICE Trust may look to the margin posted by such Participant, such Participant's Guaranty Fund contributions and, if applicable, any recovery from a parent guarantor. ICE Trust will also provide a one-time priority Guaranty Fund contribution of up to \$50 million funded over time as set forth in Chapter 8 of the ICE Trust Rules. In addition to this priority Guaranty Fund contribution, ICE Trust will contribute an additional \$50 million to the Guaranty Fund.<sup>20</sup> At its discretion, ICE Trust will be authorized to use, to the extent needed, other ICE Trust Participants' Guaranty Fund contributions to satisfy any obligations of the defaulting ICE Trust Participant; provided that, any recovery from the defaulting ICE Trust Participant, its parent guarantor, if any, or the sale of the defaulting ICE Trust Participant's positions in ICE Trust will first be used to refund any amounts utilized by ICE Trust from contributions of non-defaulting ICE Trust Participants to the Guaranty Fund.

In the event that the non-defaulting ICE Trust Participants' contributions to the Guaranty Fund are less than the remaining obligations of the defaulting ICE Trust Participant, ICE Trust will require the non-defaulting ICE Trust Participants to contribute additional capital, equal to such excess. However, an ICE Trust Participant can limit the amount of this additional assessment to an amount equal to such Participant's Guaranty Fund contribution immediately prior to the relevant default by contributing such amount and withdrawing from ICE Trust, with the withdrawal effective as described in the ICE Trust Rules.

These margin and credit support requirements will help to mitigate the counterparty credit risk that ICE Trust faces as a central counterparty, and will also help to mitigate counterparty credit risk more broadly within those portions of the CDS market that are cleared through ICE Trust. The use of dynamic margin requirements will help to ensure that each ICE Trust Participant is sufficiently collateralized at any point in time based on prevailing market

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<sup>20</sup> This second \$50 million will be contributed over time and will be applied to satisfy obligations on a pro rata basis with other ICE Trust Participants' Guaranty Fund Contributions as set forth in the ICE Trust Rules.

conditions and ICE Trust Participant position risk. Moreover, the Guaranty Fund and the mutualization protocol will help to ensure that, in the case of an occurrence of an extreme multiple-counterparty default scenario, ICE Trust will have adequate credit support and resources to contain the resulting risk and to maintain the integrity of the cleared CDS market. The ongoing supervision of the Federal Reserve and NYSBD will help to ensure that ICE Trust maintains a robust, adequate and dynamic credit support regime.

E. Liquidation of a Defaulting ICE Trust Participant

Following a default by an ICE Trust Participant, ICE Trust has a number of tools available to it under the ICE Trust Rules to ensure an orderly liquidation and unwinding of the open positions of such defaulting Participant. In the first instance, upon determining that a default has occurred, ICE Trust will have the ability to immediately enter into replacement CDS transactions with other ICE Trust Participants that are designed to mitigate, to the greatest extent possible, the market risk of the defaulting ICE Trust Participant's open positions. For open positions in which there is no liquid trading market, ICE Trust may enter into covering CDS transactions for which there is a liquid market and that are most closely correlated with such illiquid open positions. Such cover transactions will help to minimize increases in the losses with respect to a defaulting ICE Trust Participant's illiquid open positions while ICE Trust is seeking to close out these open positions.

After entering into covering transactions in the open market, if any, ICE Trust will seek to close out any remaining open positions of the defaulting ICE Trust Participant (including any initial covering transactions) by using one or more auctions or other commercially reasonable unwind processes. The ICE Trust Rules will prohibit ICE Trust from entering into any replacement transaction if the price of such transaction would be below the least favorable price that would be reasonable to accept for such replacement transaction. This provision is designed to prevent ICE Trust from entering into replacement transactions at unnecessarily depressed prices in times of market stress. To the extent ICE Trust is not able to enter into the necessary replacement transactions through auctions or open market processes, ICE Trust will be entitled to allocate such replacement transactions to the remaining Participants at the floor price established by ICE Trust.

At any time following a default by an ICE Trust Participant, ICE Trust is empowered to use the margin and credit support held by it with respect to such ICE Trust Participant (including such defaulting ICE Trust Participant's contributions to the Guaranty Fund) and any amounts recovered from a parent guarantor of such ICE Trust Participant to satisfy any remaining obligations of the ICE Trust Participant to ICE Trust, including any costs incurred by ICE Trust in liquidating the margin and credit support of such defaulting ICE Trust Participant. ICE Trust has the right to liquidate, convert currency, and apply any such property as may be necessary to

satisfy such obligations. In addition, at its discretion, ICE Trust may draw on the contributions of ICE Trust and other Participants to the Guaranty Fund, as described in Section II.D.2.

F. Daily Mark-to-Market Prices

ICE Trust will calculate a daily mark-to-market price for each type of CDS cleared by it based on end-of-day prices submitted to it by ICE Trust Participants. On a daily basis, each ICE Trust Participant will be required to provide to ICE Trust (either directly or through a designated third-party)<sup>21</sup> an accurate end-of-day price (in either credit spread or price format according to product convention, and either in mid-point or bid/offer terms) for each type of cleared CDS in which such ICE Trust Participant has a cleared position. ICE Trust will determine from time to time, with input from the relevant ICE Trust Participants, an agreed upon default bid/offer range to be applied to mid-point submissions and a notional amount for each type of cleared CDS based on then-current market conditions.

For each end-of-day price that is submitted as a credit spread, ICE Trust will utilize an industry standard model to derive a price-based format. Once in a price-based format, ICE Trust will apply the agreed upon bid/offer range to all midpoint submissions. For each end-of-day price that is submitted as a bid/offer spread greater than the agreed upon range, ICE Trust will determine the mid-point price of the submitted bid/offer spread and apply the agreed upon bid/offer range to that mid-point price.

ICE Trust will independently rank these bid and ask prices by highest bid and lowest ask. The mark-to-market price will be determined by pairing any locking or crossing bid/ask prices to reveal the first non-crossed, non-locked bid/offer pair (the “Best Bid-Best Offer” or “BBO”), and determining the point at which the most trade volume will occur within the BBO range.

If ranking of bids and offers does not result in any crossed or locked interests, then the daily mark-to-market price will be the mid-point of the BBO range. If ICE Trust determines it appropriate under the circumstances to protect the interests of ICE Trust and the ICE Trust Participants, ICE Trust may establish a mark-to-market price that deviates from this outcome.

Further, as part of the CDS clearing process and in order to enhance the reliability of the submitted end-of-day prices, ICE Trust Participants whose prices lock or cross will periodically

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<sup>21</sup> ICE Trust intends to enter into arrangements with third parties to perform daily mark-to-market price calculations, matched interest allocation and related services. Currently, with respect to Index CDS based on the untranch CDX North American Investment Grade, High Yield and Crossover indices, ICE Trust intends to enter into an agreement with the Markit Group, the publisher of these indices, to provide the services described in this sub-section. ICE Trust anticipates that, as it begins to clear other types of CDS, it will enter into similar agreements with appropriate third parties.

be required to trade at prices determined pursuant to the methodology for determining the mark-to-market price.<sup>22</sup>

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We believe that the above described clearing services to be offered by ICE Trust will significantly reduce many of the credit and operational risks faced by the major participants in the cleared CDS market and make a significant contribution to the efficacy and efficiency of the CDS market and the mitigation of systemic risk.

### III. Regulatory Status of Credit Default Swaps

#### A. Current Regulatory Status of CDS

It is uniformly accepted that CDS transactions, as currently conducted, qualify as “security-based swap agreements” under Section 206B of the GLBA, and therefore are not securities for purposes of the Acts.<sup>23</sup> As a result, CDS transactions are generally not subject to regulation under either of the Acts, with the exception of certain specifically enumerated anti-fraud, insider trading, short swing profit and anti-manipulation provisions.<sup>24</sup> As described below, the consequences of clearing CDS through ICE Trust raise a potential question regarding the status of CDS as security-based swap agreements.

As a threshold matter, under Section 206B of the GLBA, in order for a CDS to qualify as a security-based swap agreement, it must be a “swap agreement” as defined in GLBA Section 206A.<sup>25</sup> Under Section 206A(a) of the GLBA, a “swap agreement” includes:

“any agreement, contract, or transaction . . . the material terms of which (other than price and quantity) are subject to individual negotiation, and that —

\* \* \*

(2) provides for any purchase, sale, payment or delivery (other than a dividend on an equity security) that is dependent on the occurrence, non-occurrence, or the

<sup>22</sup> For the avoidance of doubt, ICE Trust intends that the relief requested herein include an exemption from registration as an exchange or compliance with Regulation ATS as a result of the mark-to-market trading requirement described above.

<sup>23</sup> See Exchange Act Section 3A(b) and Securities Act Section 2A(b) (security-based swap agreements are not securities under the Acts).

<sup>24</sup> 15 U.S.C. §§ 78c-1(b), 77b-1(b), 78c Note and 78c(a)(10), respectively.

<sup>25</sup> GLBA Section 206C.

extent of the occurrence of an event or contingency associated with a potential financial, economic, or commercial consequence; [or]

(3) provides on an executory basis for the exchange, on a fixed or contingent basis, of one or more payments based on the value or level of one or more... securities, instruments of indebtedness, indices... or other financial or economic interests or property of any kind, or any interest therein or based on the value thereof, and that transfers, as between the parties to the transaction, in whole or in part, the financial risk associated with a future change in any such value or level without also conveying a current or future direct or indirect ownership interest in an asset (including any enterprise or investment pool) or liability that incorporates the financial risk so transferred, including any such agreement, contract, or transaction commonly known as a... , credit default swap[.]<sup>26</sup> (Emphasis added.)

Because CDS – whether physically settled or cash-settled – involve a payment or delivery that is dependent on the occurrence of a credit event, it is clear that CDS are covered under Section 206A(a)(2). It is equally clear from the highlighted language at the end of Section 206A(a)(3) that Congress specifically intended credit default swaps to qualify as swap agreements.<sup>27</sup>

We note that GLBA Section 206A(b) excludes a number of transactions that would otherwise meet the requirements of Section 206A(a) from the definition of swap agreement.<sup>28</sup> Based on the plain meaning of these provisions, Congress’s clear intent and applicable principles of statutory construction, we believe that none of the exclusions in Section 206A(b) operates to carve out CDS from the definition of swap agreement.<sup>29</sup>

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<sup>26</sup> GLBA Section 206A(a).

<sup>27</sup> We note that in 2000, credit default swaps included both physically-settled and cash-settled CDS.

<sup>28</sup> GLBA Section 206A(b)(1) (carving out securities options) and Section 206A(b)(4) (carving out any agreement, contract, or transaction providing on a contingent basis for the delivery of securities but *specifically* preserving transactions providing for purchases or sales of securities predicated on contingencies that might reasonably be expected to affect or be affected by the creditworthiness of a party other than a party to the transaction).

<sup>29</sup> As noted in footnote 28, Section 206A(b)(1) excludes from the definition of swap agreement various securities options, including puts, calls and options on securities. While CDS can resemble certain types of securities options, we believe, based on long-settled and well-established principles of statutory construction, that this provision does not exclude CDS from the definition of swap agreement. Courts, confronted with the need to reconcile a general provision that is in conflict with a more specific provision in the same statute, have consistently held that the more specific provision governs, to the extent of the conflict. *See, e.g., Ginsberg & Sons v. Popkin*, 285 U.S. 204 (1932); *Kepner v. U.S.*, 195 U.S. 100 (1904); *Maiatico v. United States*, 302 Fed. 2d 880 (DC Cir. 1962). It seems clear that the exception for agreements involving credit-based contingencies contained in Section 206A(b)(4) is significantly more

A security-based swap agreement is defined, in turn, under GLBA Section 206B as a “swap agreement” of which a material term is based “on the price . . . of any security or any group or index of securities, or any interest therein.”<sup>30</sup> In the case of CDS that provide for the potential delivery of a debt security against a specified payment amount, or a cash payment based on the value of a debt security, many market participants have assumed that such CDS may be regarded as security-based swap agreements. To the extent CDS are not security-based swap agreements under Section 206B, they would constitute non-security-based swap agreements under GLBA Section 206C (“non-security-based swap agreement means any swap agreement . . . that is not a security-based swap agreement . . .”).<sup>31</sup>

Notwithstanding the foregoing, for purposes of Section 206A(a) of the GLBA, in order for a CDS to be considered a swap agreement, it is not sufficient that the CDS falls within one of the enumerated clauses of that section. It is also necessary that the “material terms” of the CDS (other than price and quantity) be “subject to individual negotiation”.<sup>32</sup> As noted above, currently, market participants individually negotiate the terms of the ISDA Schedule, Confirmation and (if applicable) CSA that will govern individual CDS based on each party’s own assessment of its needs and requirements and the counterparty risk presented by the other party.

#### B. Legal Uncertainty Raised by Central Counterparty Clearing Structure

In order to reduce its counterparty risk, it is essential that ICE Trust, as a central counterparty, maintain an exactly matched book of CDS positions at all times. In addition, in order to reduce documentation risk (and therefore market and credit risk), all of the CDS that are cleared and settled through ICE Trust must be subject to similar credit risk mitigation and collateral terms and must be governed by uniform terms. The practical effect of this is that the bilaterally negotiated terms of all CDS transactions submitted to ICE Trust for clearing must be superseded by the ICE Trust Rules. Because these rules will contain uniform credit support and contractual terms applicable to each similar CDS and to all Participants, irrespective of any

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specific and narrowly focused than the more general exception for securities options contained in Section 206A(b)(1). Similarly, in *Gustafson v. Alloyd Co., Inc.*, 513 U.S. 561 (1995), the Supreme Court held that, “the Court will avoid a reading [of a statute] which renders some words absolutely redundant.” *Id.* at 574. Accord, *Kawaaauhau v. Geiger*, 523 U.S. 57, 62 (1998); *U.S. v. Alaska*, 521 U.S. 1 (1997); *Mackey v. Lanier Collection Agency & Service, Inc.*, 486 U.S. 825, 837 (1988); *U.S. v. Menasche*, 348 U.S. 528, 536-537 (1955). If the securities option exclusion in Section 206A(b)(1) were read to exclude CDS, this would render certain provisions from Sections 206A(a)(3) and 206A(b)(4), effectively meaningless and redundant.

<sup>30</sup> GLBA Section 206C.

<sup>31</sup> GLBA Section 206C.

<sup>32</sup> GLBA Section 206A(a).

single Participant's unique position or requirements, there arises some uncertainty as to whether the terms of the CDS cleared and settled through ICE Trust are "subject to individual negotiation" within the meaning of GLBA Section 206A(a).

As a threshold matter, we note that we are aware of no legislative history or judicial precedent construing the individual negotiation requirement of GLBA Section 206A(a). It is clear from the text of the provision, however, that this prong of the swap agreement definition looks to the circumstances prevailing at the time a transaction's terms are negotiated by the parties. Even though the material terms of CDS submitted to ICE Trust for clearing are superseded by a uniform set of rules, Participants, at the time they enter into a CDS transaction, are free to specify any terms they may wish to negotiate, including whether or not to submit the relevant transaction to ICE Trust for clearing.

Although the framework for the regulation of securities broker-dealers has been effective for traditional securities activities, we believe that it has not provided a commercially practical framework for the conduct of broad categories of over-the-counter derivatives activities.<sup>33</sup> Given that ICE Trust Participants will be the most sophisticated derivatives market participants, will be acting solely for their own accounts (or the account of their Affiliates) and will be limited to firms who are subject to regulation or consolidated supervision by a financial regulator, we believe little would be gained by subjecting these Participants to regulation as securities dealers.

On the other hand, requiring dealer regulation and imposing the Exchange Act's securities regime on cleared CDS would create a significant and burdensome dislocation of this market and, of greatest concern, would almost certainly present an extremely significant obstacle to the adoption of clearing for the CDS market. We believe the imposition of such additional regulation and regulatory constraints would be unwarranted, would not constitute an efficient allocation of regulatory resources, and would not serve the public interest. Equally important, however, given the size and significance of the CDS market, proceeding in the face of any material legal uncertainty as to the regulatory status of CDS cleared through ICE Trust would be unacceptable both to market participants and the official sector. Either outcome would produce undesirable consequences and jeopardize the important benefits that the introduction of clearing for CDS can provide.

We believe that an optimal result can be achieved, without any need to resolve the status of cleared CDS, through the issuance by the Commission of an order granting exemptive relief to

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<sup>33</sup> Although qualifying banks are eligible for exemption from registration as dealers under the Exchange Act for dealing activities involving securities that qualify as "swap agreements" under GLBA Section 206, this definition also includes a requirement that the relevant agreement be "individually negotiated," raising a question that is essentially identical to that raised under the swap agreement definition in GLBA Section 206A(a).

ICE Trust, the ICE Trust Participants and inter-dealer brokers, for the avoidance of legal uncertainty, on terms and conditions that would, in effect, permit ICE Trust, the ICE Trust Participants and inter-dealer brokers to continue to conduct business in cleared CDS on the basis that such transactions would be treated as security-based swap agreements under the Exchange Act. We believe such relief would be consistent with the public interest and the standards for the issuance of exemptive relief under the Acts as described in Section IV below.

#### IV. Proposed Exemptive Relief

##### A. Clearing Agency Relief

##### 1. Regulatory Supervision

As a New York State chartered limited purpose trust company and a member bank of the Federal Reserve, ICE Trust will be subject to comprehensive ongoing regulatory oversight by both the Federal Reserve and the NYSBD (sometimes referred to as the “Bank Regulators”). Each of the Bank Regulators will review and approve the ICE Trust Rules during ICE Trust’s formation process and, after formation, will engage in ongoing oversight and regulation of ICE Trust’s clearing operations.

When reviewing ICE Trust’s application for membership, the Federal Reserve will consider whether the operations of ICE Trust (including the ICE Trust Rules and the procedures of ICE Trust) will promote the public interest, ensure the stability of the financial system and protect the interests, assets and funds of the ICE Trust Participants.<sup>34</sup> As noted earlier, the Federal Reserve has stated in Senate testimony that it will apply the BIS IOSCO CCP Recommendations in evaluating any proposal to organize a bank that seeks to act as a central counterparty for clearing credit derivatives, such as ICE Trust.<sup>35</sup>

In approving the charter for ICE Trust under New York law, the NYSBD evaluated whether the company’s operations – predominantly CDS settlement and clearing – will be conducted in a safe and sound manner, consistent with the ICE Trust Rules, and will be in the public interest.<sup>36</sup> Once ICE Trust begins its operations, it will be subject to ongoing oversight and regulation by the Bank Regulators. The most prominent feature of this ongoing oversight will be periodic examinations by the federal and state banking regulators of the operations and records of ICE Trust, the ICE Trust Rules and procedures of ICE Trust and its compliance with

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<sup>34</sup> See, e.g., 12 C.F.R. § 208.3; Federal Reserve Board, SR Letter 91-17, Application and Supervisory Standards for de novo State Member Banks (July 22, 1991).

<sup>35</sup> Parkinson Testimony, p. 5.

<sup>36</sup> NY Banking Law §§ 14, 24 and 25.



these rules and procedures. Some of these periodic examinations will include on site examinations.

The chief supervisory mandate of the Bank Regulators is to (1) ensure that ICE Trust has rules and procedures to ensure that it conducts its operations in a safe and sound manner and (2) protect the public interest and the assets, funds and interests of the ICE Trust Participants.<sup>37</sup> In order to effectively carry out this mandate, the bank supervisors take a risk-focused approach to examinations and oversight.<sup>38</sup> We expect that both the Bank Regulators will focus on those areas of ICE Trust's operations that are likely to generate the most risk (including operational risk, counterparty risk and credit risk) to the financial sector and the general public.

Bank examiners possess extensive authority to review virtually all of the operations, books and records of a bank.<sup>39</sup> Generally, the Bank Regulators will coordinate their examinations, and we expect that the Bank Regulators will (1) routinely ask for data and information about the operations of ICE Trust, (2) review the implementation of and compliance with the ICE Trust Rules and the procedures of ICE Trust, and (3) conduct on-site and off-site examinations of ICE Trust. We expect that bank examiners will review ICE Trust's policies and procedures, both initially and as they are applied in operation, will recommend improvements, modifications and enhancements whenever they deem appropriate, and will raise questions as to whether specific observed practices are consistent with the ICE Trust's policies and procedures.

The Bank Regulators will require ICE Trust to have in place comprehensive written policies and procedures, approved by ICE Trust's board of managers, governing all aspects of ICE Trust's operations, including its clearing services. The Bank Regulators also will require ICE Trust to have competent and independent compliance and audit functions, to ensure that policies and procedures are followed.<sup>40</sup> The staffing requirements for these functions are typically much higher in a bank than in a non-bank company.

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<sup>37</sup> 12 U.S.C. § 221 *et seq.* (Federal Reserve Act); New York Banking Law § 14.

<sup>38</sup> See, e.g., Federal Reserve Board, Commercial Bank Examination Manual, § 1000 Examination Strategy and Risk-Focused Examinations (March 1994).

<sup>39</sup> 12 U.S.C. §§ 248(a); 325, 326 (Federal Reserve); NYBL § 36, 38.

<sup>40</sup> 12 C.F.R. § 208, Appendix D-1, Interagency Guidelines for Establishing Standards for Safety and Soundness; see also e.g., Bank for International Settlements, Compliance and the Compliance Function in Banks, April 2005; Federal Reserve Board, SR Letter 03-5 dated April 22, 2003, transmitting Interagency Policy Statement on the Internal Audit Function and Its Outsourcing, March 17, 2003.

2. Statutory Criteria for Exemption from Registration as a Clearing Agency

Under Section 17A(b)(1) of the Exchange Act, the Commission may “exempt any clearing agency ... from any provisions of this section or the rules or regulations thereunder, if the Commission finds that such exemption is consistent with the public interest, the protection of investors, and the purposes of this section, including the prompt and accurate clearance and settlement of securities transactions and the safeguarding of securities and funds.”<sup>41</sup> The Commission has stated that in order to ensure that the fundamental goals of Section 17A are met “applicants requesting exemption from clearing agency registration are required to meet standards substantially similar to those required of registrants under Section 17A.”<sup>42</sup> As a result, any entity, including ICE Trust, that seeks an exemption from registration as a clearing agency must have rules and procedures that are substantially equivalent to those required of clearing agencies registered under Section 17A of the Exchange Act.

The Federal Reserve has published policy guidance that establishes what it expects to see in the operations, governance arrangements, and procedures and rules of a clearinghouse that is a member bank (the “FRB Clearing Policy”).<sup>43</sup> The FRB Clearing Policy is based upon the BIS IOSCO CCP Recommendations. ICE Trust expects and intends that its operations, governance arrangements, and rules and procedures will comply with the FRB Clearing Policy. Furthermore, the FRB has said that it expects entities such as ICE Trust to meet “the specific risk management principles and minimum standards” established by the FRB Clearing Policy<sup>44</sup> and that it will be guided by the central counterparty requirements specified in the FRB Clearing Policy “when exercising its authority in ... supervising state member banks.”<sup>45</sup> The principles in the FRB Clearing Policy and the expected ICE Trust Rules and the procedures that ICE Trust is in the process of adopting, which will comply with the FRB Clearing Policy, will ensure that ICE Trust is in substantial compliance with the requirements of Section 17A of the Exchange Act.

Significantly, the Commission has itself previously noted that “the scheme of U.S. federal banking oversight of a clearing agency should help to provide U.S. investors and the U.S. national clearance and settlement system with a level of protection in the areas of custody,

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<sup>41</sup> Exchange Act Section 17A(b)(1).

<sup>42</sup> Securities Exchange Act Release No. 38589, 62 FR 26833 (Notice of filing of application for exemption from registration as a clearing agency) (the “Euroclear Notice”), p. 26839.

<sup>43</sup> Federal Reserve Board. Federal Reserve Policy on Payments System Risk. FRRS 9-1000 et seq. (September 2008).

<sup>44</sup> FRB Clearing Policy, p. 10.

<sup>45</sup> FRB Clearing Policy, p. 4.

clearance, and settlement risks that is comparable to those achieved with full clearing agency registration.”<sup>46</sup>

i. Safeguarding of Securities and Funds and Prompt and Accurate Clearance and Settlement

Sections 17A(b)(3)(A) and (F) of the Exchange Act require that a clearing agency be “so organized” and have the capacity to (1) “facilitate the prompt and accurate clearance and settlement of securities transactions and derivative agreements, contracts, and transactions for which it is responsible,” and (2) adequately “safeguard securities and funds in its custody or control or for which it is responsible.”<sup>47</sup>

The FRB Clearing Policy requires that, with respect to transactions that are submitted to a clearing agency, the clearing agency be able to provide “prompt final settlement on the day of value, preferably during the day and at a minimum at the end of the day” and that “[c]onfirmation of trades between direct market participants should occur as soon as possible after trade execution, but no later than the trade date (T+0).”<sup>48</sup> The FRB Clearing Policy also requires that a central counterparty “hold assets in a manner whereby risk of loss or of delay in its access to them is minimized.”<sup>49</sup> As a result, the ICE Trust Rules and the accompanying procedures adopted by ICE Trust will promote (1) the public interest (including the protection of investors), (2) the prompt and accurate clearance and settlement of CDS transactions and (3) the safeguarding of assets and funds of the ICE Trust Participants.

The ICE Trust Rules will facilitate prompt and accurate clearance by requiring (1) that all submitted trade confirmations for a specific type of CDS contain all the information necessary for accurate settlement and conform to a predetermined form and (2) that on the same day that ICE Trust novates matched trades for clearing, the daily statement of trades that submitting ICE Trust Participants receive will reflect these newly cleared trades (provided that no disagreement exists with respect to the terms of the trade confirmations submitted by such Participants).

ICE Trust will safeguard ICE Trust Participant funds and property in its possession by using well capitalized and appropriately experienced banks to effect cash payment settlements and to hold margin and Guaranty Fund contributions. ICE Trust will use select settlement banks to effect on-going cash payments (other than coupon payments, which will be effected through

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<sup>46</sup> Securities Exchange Act Release No. 34-39643, 63 FR 8232 (Order approving application for exemption from registration as a clearing agency) (the “Euroclear Approval”), p. 8235.

<sup>47</sup> Exchange Act Sections 17A(b)(3)(A) and (F).

<sup>48</sup> FRB Clearing Policy, p. 11 – 12.

<sup>49</sup> FRB Clearing Policy, p. 14.

Deriv/SERV's Coupon Payment Facility). These settlement banks will be required to be well-capitalized and have adequate experience in automatic settlement models. ICE Trust and these settlement banks will use SWIFT secure messaging for all settlement and bank transfers. Also, any margin or Guaranty Fund contributions posted by a Participant will be held in custody accounts with well-capitalized banks.

ii. ICE Trust Participant Standards

Section 17A(b)(3)(B) of the Exchange Act requires that a clearing agency allow certain enumerated types of entities to become members. Section 17A(b)(4), however, permits a clearing agency to deny participation to any person if "such person does not meet such standards of financial responsibility, operational capability, experience, and competence as are prescribed by the rules of the clearing agency."<sup>50</sup> These participation standards must not be "designed to permit unfair discrimination in the admission of participants or among participants in the use of the clearing agency."<sup>51</sup>

These criteria are consistent with relevant provisions of the BIS IOSCO CCP Recommendations that have been adopted by the Federal Reserve.<sup>52</sup> Additionally, consistent with the participant criteria requirements of Section 17A of the Exchange Act, the FRB Clearing Policy requires that a central counterparty's criteria for participation "permit fair and open access" to the clearing system, while ensuring that a participant has "sufficient financial resources and robust operational capacity to meet obligations arising from participation in the central counterparty."<sup>53</sup>

In accordance with these requirements, the ICE Trust Rules will provide that each CDS participant, including the regulated entities listed in Section 17A(b)(3)(B) of the Exchange Act, that meets the objective, non-discriminatory membership criteria described above under Section II.B of this submission is eligible to become an ICE Trust Participant.

iii. Fair Representation

Section 17A(b)(3)(C) of the Exchange Act requires that a clearing agency have rules that ensure that its "shareholders (or members) and participants" are fairly represented "in the selection of its directors and administration of its affairs."<sup>54</sup> Rather than prescribing a single

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<sup>50</sup> Exchange Act Section 17A(b)(3)(B) and 17A(b)(4).

<sup>51</sup> Exchange Act Section 17A(b)(3)(F).

<sup>52</sup> BIS IOSCO CCP Recommendations, p. 4.

<sup>53</sup> FRB Clearing Policy, p. 13.

<sup>54</sup> Exchange Act Section 17A(b)(3)(C).

method for determining what constitutes “fair representation”, the Commission looks to ensure that the rules of the clearing agency give “a significant voice in the direction of the affairs of the clearing agency” to the clearing agency members and participants.<sup>55</sup>

The FRB Clearing Policy similarly requires that governance arrangements for a central counterparty should be designed “to support the objectives of owners and participants.”<sup>56</sup>

ICE Trust believes that its rules and procedures will give the ICE Trust Participants a “significant” voice in the administration of ICE Trust’s affairs. Chapter 5 of the ICE Trust Rules will establish a risk management committee consisting of nine members appointed by the ICE Trust Participants, a member appointed by ICE Holding LP who is an independent manager of ICE Trust and two other members appointed by ICE Holding LP who are officers of ICE Trust (the “Risk Committee”).<sup>57</sup> Certain material changes to the ICE Trust Rules and procedures or governance arrangements of ICE Trust, as described in Chapter 5 of the ICE Trust Rules, must be referred to the Risk Committee. The Risk Committee will provide its recommendations to the Board which will have final authority to act on the matter. The composition of the Risk Committee and the power given to it, which is subject to change, is designed to ensure that the ICE Trust Participants will be fairly represented with respect to the administration of ICE Trust and that any significant changes to the rules and procedures are consistent with the objectives of the ICE Trust Participants.

The initial Board will consist of eleven individuals<sup>58</sup> each of whom has been reviewed and approved by the NYSBD pursuant to the NYSBD’s standard procedures for newly-chartered trust companies, which is required for managers of New York trust companies elected during the first three years of a trust company’s existence.<sup>59</sup> ICE Holding LP will have the right to designate seven individuals to become members of the Board of ICE Trust. The Risk Committee

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<sup>55</sup> Euroclear Approval, p. 8237.

<sup>56</sup> FRB Clearing Policy, p. 14.

<sup>57</sup> Initially, each of the initial Participants listed in footnote 9 will appoint one member to the Risk Committee with the sole exception that Bank of America and Merrill Lynch jointly will appoint only one member. Thereafter, on an annual basis, each of the five initial Participants that had the highest trading volume for the past year will appoint one member to the Risk Committee and the four other Participants, at the time of appointment, with the highest trading volume for the past year will each appoint one member to the Risk Committee.

<sup>58</sup> Upon closing, ICE Trust’s board of managers will consist of seven individuals, each of whom has been reviewed and approved by the NYSBD. It is expected that the additional four individuals, who will each be designated by the Risk Committee and appointed by ICE Holding LP, will be appointed as soon as practically possible after closing.

<sup>59</sup> Information and Procedure for the Organization of a Commercial Bank under New York Banking Law, Conditions of New Banks, No. 3, at <http://www.banking.state.ny.us/iac2b.htm>

will have the right to designate four individuals to become members of the Board of ICE Trust. The Risk Committee individuals will be designated to and elected by ICE Holding LP. Four of ICE Holding LP's and two of the Risk Committee designees must be independent in accordance with the Exchange Act, the New York Stock Exchange listing standards and ICE's Board of Directors Governance Principles, and the other manager appointees need not be independent; in addition, the designees must be reasonably acceptable to the Board. In the future, ICE Holding LP must consult in good faith with the Risk Committee prior to electing any individuals as ICE Holding LP's replacements for the initial members, with respect to the skills and experience of such proposed replacement member, and is not permitted to appoint directors, officers or employees of any Participant as an independent manager of ICE Trust.

In the event that certain specified actions are to be taken by ICE Trust, the prior approval of the Board must be obtained, and for that purpose the required quorum will be two-thirds, rather than a majority, of the Board. Thus, this special quorum provision will require that at least eight members of the Board be present at a meeting to discuss any of the specified actions, including at least one designee of the Risk Committee. The specified actions include modification of (a) the structure, size or application of the Guaranty Fund, (b) the methodology for calculating a Participant's contribution to the Guaranty Fund, (c) the types of currency or assets eligible to be a Participant's Guaranty Fund contribution, (d) provisions relating to the use, rehypothecation or investment of collateral in the Guaranty Fund, and (e) various other provisions that the Participants have indicated should be subject to this requirement and as set forth in the Rules. Accordingly, the views of the Participants will be required to be heard by the Board before taking any of the above-mentioned actions.<sup>60</sup>

iv. Capacity to Enforce Rules and Discipline ICE Trust Participants

Section 17A(b)(3)(A) of the Exchange Act requires that a clearing agency have the capacity to enforce "compliance by its participants with the rules of the clearing agency."<sup>61</sup> In addition, Sections 17A(b)(3)(G) and (H) require that a clearing agency have a system to discipline participants that violate its rules and that the procedures for disciplining a participant be fair and equitable.<sup>62</sup> The Commission has further required that:

"a clearing agency should have available and should employ an array of sanctions appropriate to the violations the clearing agency may encounter. Also, the clearing agency's rules should establish the agency's authority and procedures respecting

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<sup>60</sup> There is an exception to the consultation requirement with respect to emergencies and failure to establish a two-thirds quorum after calling multiple meetings.

<sup>61</sup> Exchange Act Section 17A(b)(3)(A).

<sup>62</sup> Exchange Act Section 17A(b)(3)(G) and (H).

interpretation of its rules and the bringing of charges where rule violations appear to have occurred, and the rules should describe the manner in which disciplinary authority is to be exercised.”<sup>63</sup>

The FRB Clearing Policy, while not as detailed as the corresponding provisions of Section 17A, requires that a clearing system should establish “clear risk management objectives” and should “set and enforce clear lines of responsibility and accountability for achieving these objectives”.<sup>64</sup> In addition, under the policy, the governance arrangements of the clearing system “should be effective, accountable and transparent.”<sup>65</sup> In order to implement reinforcing arrangements that meet these criteria, ICE Trust will employ sanctions for noncompliance that reflect the extent to which such noncompliance compromises ICE Trust’s risk management objectives, and the ICE Trust Rules will establish fair and transparent procedures for enforcing compliance with its rules and procedures. In particular, Chapter 7 of the ICE Trust Rules will contain detailed rules with respect to disciplinary actions that may be taken by ICE Trust and rights to, and the process of, appeal by the Participant that is being disciplined. Also, under the ICE Trust Rules, ICE Trust will be required to consult with each of the Bank Regulators prior to terminating, or rescinding the clearing privileges of, an ICE Trust Participant.

Although the clearing house will not be a self regulatory organization (“SRO”) as that term is defined in Section 3(a)(26) of the Exchange Act,<sup>66</sup> a number of ICE Trust Rules empower the clearing house variously to discipline, fine or charge, or to suspend, limit the activities of or terminate the participation of, any ICE Trust Participant who fails to comply with applicable ICE Trust Rules. We note that the Commission has, in a similar case involving a clearing organization that was a limited purpose New York trust company, determined SRO status to be unnecessary to achieving the purposes of the Exchange Act.

v. Clearing Fund

The Standards Release requires that a registered clearing agency establish a clearing fund that: “(i) is composed of contributions based on a formula applicable to all users, (ii) is in cash or highly liquid securities, and (iii) is limited in the purposes for which it may be used.”<sup>67</sup> The Commission has in the past exempted from registration a clearing agency that did not have a clearing fund, but instead had “financial and operational risk management mechanisms ... and

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<sup>63</sup> Securities Exchange Act Release No. 16900 (June 17, 1980), 45 FR 41920 (the “Standards Release”), p. 10.

<sup>64</sup> FRB Clearing Policy, p. 8.

<sup>65</sup> FRB Clearing Policy, p. 11.

<sup>66</sup> 15 U.S.C. § 78c(a)(26).

<sup>67</sup> Standards Release, p. 16.

other operational safeguards to substantially reduce the risk of financial loss” to the clearing system and its participants.<sup>68</sup>

While the FRB Clearing Policy does not specifically require a “clearing fund” *per se*, it does require that a central counterparty (1) have “margin requirements, other risk control mechanisms, or a combination of both, [to] limit its exposures to potential losses from defaults by its participants in normal market conditions” and (2) “maintain sufficient financial resources to withstand ... a default by the participant to which it has the largest exposure in extreme but plausible market conditions”.<sup>69</sup> Finally, the FRB Clearing Policy requires that any participant funds held by a central counterparty “should be held in instruments with minimal credit, market, and liquidity risks.” These criteria will require ICE Trust to have risk management and credit support mechanisms that substantially reduce the risk of financial loss to ICE Trust and the ICE Trust Participants, consistent with the requirements of the Standards Release.

In accordance with these requirements, ICE Trust will establish a strict margin, guaranty fund and credit support regime as further described above under Section II.D of the submission.

vi. Dues, Fees and Charges

Section 17A(b)(3)(D) of the Exchange Act requires that a clearing agency allocate equitably among its participants “reasonable dues, fees, and other charges.”<sup>70</sup> In addition, the Commission has said that “rules providing for dues, fees or other charges must be designed to meet the other objectives of Section 17A(b)(3) of the Exchange Act.”<sup>71</sup>

Although the FRB Clearing Policy does not explicitly address the issue of participant dues, fees and charges, the FRB Clearing Policy does require that all central counterparties should have objective and transparent governance arrangements that permit fair and open access for all of the central counterparty’s participants.<sup>72</sup> We believe that discriminatory dues, fees and charges would not be consistent with this criteria, and that the Federal Reserve, in evaluating whether to admit ICE Trust as a member bank, will require as much. Moreover, we expect that, going forward, any dues, fees or charges that ICE Trust charges to the ICE Trust Participants will be required by the Federal Reserve to be fair and non-discriminatory and not contrary to the public interests served by Section 17A or the FRB Clearing Policy.

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<sup>68</sup> Euroclear Approval, p. 8236.

<sup>69</sup> FRB Clearing Policy, p. 13 – 14.

<sup>70</sup> Exchange Act Section 17A(b)(3)(D).

<sup>71</sup> Standards Release, p. 20.

<sup>72</sup> FRB Clearing Policy, p. 13.



vii. Changes in Rules

Section 19(b) of the Exchange Act requires that a registered clearing agency file with the Commission all proposed amendments, additions or changes to the rules and procedures of the registered clearing agency.<sup>73</sup> In addition, under Section 19(b), the Commission is generally required to approve or disapprove any proposed rule change. The Commission may approve the proposed rule change only if “it finds that such proposed rule change is consistent with the requirements of this title and the rules and regulations thereunder applicable to such organization.”<sup>74</sup>

Under the operating agreement of ICE Trust, ICE Trust’s board approval – which approval will take into consideration the recommendation of the Risk Committee – will be required to make certain significant rule changes (for example, changes to rules regarding risk management or credit support requirements). In the course of periodic bank examinations, Federal Reserve and NYSBD examiners routinely review minutes of board of managers meetings, resolutions adopted and issues considered by directors and senior management.<sup>75</sup> Bank examiners generally expect all significant policies and procedures of the institution – which would include the ICE Trust clearing procedures and the ICE Trust Rules – to be reviewed and approved or renewed by the institution’s board periodically, as often as annually depending on the matter, the circumstances and developments. The Bank Regulators also review and evaluate the performance of bank management and compliance function personnel in monitoring, testing and ensuring the institution’s compliance with all applicable laws and internal rules and procedures.

In practice, at any time the NYSBD and Federal Reserve could rely on a combination of statutory authority, interpretation of safety and soundness, and supervisory influence to prompt ICE Trust to review and revise any of the ICE Trust Rules or procedures and practices of ICE Trust, whenever deemed necessary to correct any deficiency or to promote the smooth and safe operation of ICE Trust, the markets and the public interest. Moreover, the Federal Reserve has said in the FRB Clearing Policy that it expects a clearing agency, such as ICE Trust, to meet the requirements of the FRB Clearing Policy.

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<sup>73</sup> Exchange Act Section 19(b).

<sup>74</sup> Exchange Act Section 19(b)(2).

<sup>75</sup> See, e.g., Federal Reserve Board, Commercial Bank Examination Manual, § 6000 “Federal Reserve Examinations” (March 1994); Federal Reserve Board SR Letter 91-17, Application and Supervisory Standards for De Novo State Member Banks (July 22, 1991).

B. Exemption of Participants from the Provisions of the Exchange Act Governing Securities Transactions

Under Exchange Act Section 36(a)(1), the Commission may “exempt any person ... or transaction, or any class or classes of persons ... or transactions, from any provision or provisions of” the Exchange Act “or of any rule or regulation thereunder, to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors”.<sup>76</sup> Any request for exemptive relief under Section 36(a)(1) must (i) “state the basis for the relief sought” and (ii) “identify the anticipated benefits for investors and any conditions or limitations the applicant believes would be appropriate for the protection of investors.”<sup>77</sup>

Congress, in granting the Commission this broad exemptive authority, intended to “incorporate flexibility into the ... regulatory scheme to reflect a rapidly changing marketplace.”<sup>78</sup> The Commission has specifically noted that this exemptive authority will allow it to address persons and transactions that “do not fit neatly into the existing regulatory framework.”<sup>79</sup>

As noted above, ICE Trust will be comprehensively regulated by state and federal banking supervisors applying a regulatory framework that the Commission has itself recognized as substantially similar to the framework administered by the Commission under Section 17A. Additionally, ICE Trust’s investors and Participants are among the most sophisticated market professionals.

From the perspective of the public interest, ICE Trust’s proposed clearing activities have the potential to provide many important benefits. Most importantly, by significantly reducing the credit and operational risks associated with the CDS activities of its Participants, ICE Trust will not merely benefit its Participants, it will reduce potential sources of contagion risk, which, in turn, will benefit all market participants, including third parties for whom Participants act as professional intermediaries, and investors who, as we have recently witnessed, are both directly and indirectly impacted by a lack of confidence in, or by other adverse developments affecting,

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<sup>76</sup> Exchange Act Section 36(a)(1).

<sup>77</sup> Securities Exchange Act Release No. 39624, 17 CFR Part 240 (Commission Procedures for Filing Application for Exemptive Relief pursuant to Section 36 of the Exchange Act) (the “Section 36 Procedures Release”).

<sup>78</sup> Securities Exchange Act Release No. 50311, 2004 WL 2609271 (Order granting application for a temporary conditional exemption pursuant to Section 36(a) of the Exchange Act by the National Association of Securities Dealers, Inc. Relating to the Acquisition of an ECN by the NASDAQ Stock Market) (“NASDAQ Order”), p. 5.

<sup>79</sup> NASDAQ Order, p. 3.

the credit markets. Indeed, senior officials within the public sector have expressed the view that it is critical that a prudent clearing framework for the OTC CDS market be developed as a matter of urgency, and ICE Trust is endeavoring to address this pressing need. ICE Trust's activities will also enhance regulatory transparency and facilitate the ability of regulators to promote market stability and avert market crises.

We believe it is significant that the activities of Participants in connection with cleared CDS will not be fundamentally different from those currently undertaken, and that will continue to be undertaken, in relation to CDS that are not submitted to ICE Trust for clearing. The only significant difference will be the risk mitigating benefits afforded by participation within a prudently organized clearing system. None of the important public policy objectives that are fostered by regulations – such as those governing disclosure, registration, listing, customer confirmations, customer account statements, rehypothecation, custody and control, and the like – are implicated by participation in ICE Trust.

Imposition of these requirements, on the other hand, would be unwarranted and burdensome on ICE Trust Participants. The requirement to transfer these activities to a registered dealer alone carries with it the need to re-document all of the hundreds and thousands of trading relationships ICE Trust Participants have or, possibly worse, to re-document significant numbers of them and bifurcate their cleared CDS activities from other CDS and related OTC derivatives activities. Not only do we see little or no benefit accruing to investors or the general public from such a requirement, we believe the resulting commitment of regulatory resources would be inefficient and would not be justified by a cost-benefit analysis. Of greatest concern, however, is that the burdens such a requirement would entail would likely erect a significant obstacle to achieving the benefits sought to be achieved by ICE Trust's proposed CDS clearing initiative.

As the Commission is aware, many Congressional leaders, the U.S. Treasury Department and the Federal Reserve have emphasized the need for prompt implementation of a clearing solution for CDS. Clearly, capital adequacy and operational risk management competencies are an extremely important component of the Exchange Act's regulatory framework and are particularly relevant to the efficacy of ICE Trust's clearing initiative. The ICE Trust Rules will, however, directly address these issues by limiting ICE Trust Participants to those institutions that are the most highly capitalized and sophisticated financial institutions and that have highly developed competencies in risk and operations management. Moreover, ICE Trust will be subject to examination by extremely sophisticated bank regulators, specifically with respect to the qualification of its Participants and the risks presented by Participants' activities to ICE Trust and to other Participants. Initially, the ICE Trust Rules will also limit Participants to institutions who are either directly regulated by a U.S. federal or foreign financial regulator or who are affiliates of such institutions and who, as a result, are subject to the consolidated supervision of the institution's holding company group by a U.S. federal or foreign financial regulator.

Equally, protections against market abuses, such as market manipulation and insider trading, are important components of the investor and public interest protections afforded under the Acts and could be as relevant to cleared CDS as to other CDS. In order to address this important regulatory objective, ICE Trust requests that the exemptive relief sought herein be limited in scope so that all provisions of the Exchange Act that are applicable to security-based swaps remain applicable to the activities of ICE Trust and its Participants in relation to CDS to be cleared by ICE Trust.<sup>80</sup>

Based on these considerations and the conditions described in Section IV.D below, we believe the general exemptive relief sought herein pursuant to Section 36(a)(1) of the Exchange Act fully satisfies the relevant conditions for exemption under that Section.

Moreover, we do not believe that the relief sought herein under that Section or Section 17A(b)(1) of the Exchange Act requires or depends upon any resolution of the question presented by the status of cleared CDS under the swap agreement definition in GLBA Section 206A(a). On the contrary, we believe that the relief sought herein is warranted whether or not one regards cleared CDS as swap agreements under GLBA Section 206A(a) or as securities. We therefore respectfully request that the Commission issue the requested relief on the substantive merits of the relevant exemptive relief, for the purpose of eliminating legal uncertainty and promoting the public benefits to be derived from ICE Trust's proposed clearing initiative, and without addressing or resolving any questions presented by the application of GLBA Section 206A(a) to cleared CDS.

C. Exemption of Inter-Dealer Brokers from the Provisions of the Exchange Act Governing Securities Transactions

As described in more detail in Section IV.B above, under Exchange Act Section 36(a)(1), the Commission may “exempt any person ... or transaction, or any class or classes of persons ... or transactions, from any provision or provisions of” the Exchange Act “or of any rule or regulation thereunder, to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors”.<sup>81</sup> Any request for exemptive relief under Section 36(a)(1) must (i) “state the basis for the relief sought” and (ii) “identify the anticipated benefits for investors and any conditions or limitations the applicant believes would be appropriate for the protection of investors.”<sup>82</sup>

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<sup>80</sup> ICE Trust acknowledges that future changes in the law applicable to CDS may affect the relief granted herein.

<sup>81</sup> Exchange Act Section 36(a)(1).

<sup>82</sup> See the Section 36 Procedures Release.

Inter-dealer brokers potentially will have an important role in the efficient and effective implementation, and continued operation, of the CDS clearing services being offered by ICE Trust. It is anticipated that ICE Trust, as part of its regular day-to-day clearing procedures, will accept for clearing CDS transactions of its Participants submitted by a number of inter-dealer brokers. As is the case in other fixed income markets, Participants that want to enter into a CDS transaction that will subsequently be submitted to ICE Trust, instead of themselves locating another Participant to transact with, may choose to submit one side of a CDS transaction to an inter-dealer broker, who will then locate another Participant willing to take the opposite side of such CDS transaction. The ability of Participants to access inter-dealer brokers for cleared CDS will ensure that a broader range of CDS transactions are submitted to and cleared by ICE Trust in an orderly manner and will provide Participants additional means through which to execute and submit CDS transactions for clearing.

As noted above, the inter-dealer brokers for whom relief is sought herein would act in relation to ICE Trust-cleared CDS transactions only for Participants who will be extremely sophisticated and well-capitalized and in circumstances where such inter-dealer brokers (a) do not handle funds or property of the Participants, (b) intermediate transactions on an agency basis, and as result do not become parties to, and are therefore not subject to the credit and market risks associated with, the CDS transacted through them, and (c) do not discipline subscribers other than by exclusion from trading.

Based on the foregoing limitations and the practical and market benefits that would be afforded by expanding the types of CDS that may be accepted by ICE Trust for clearance and settlement and the conditions described in Section IV.D below, we believe that the relief sought herein pursuant to Section 36(a)(1) of the Exchange Act is fully consistent with the standards for exemptive relief thereunder.

D. Conditions to Exemptive Relief

As a condition to the exemptive relief requested herein, ICE Trust represents to the Commission that (a) at all times after the commencement of its CDS clearing service, ICE Trust will meet the standards for central counterparties set forth in the BIS IOSCO CCP Recommendations and (b) it will submit, within 60 days after commencement of its CDS clearing service, a self-assessment to the Commission substantially similar, in form and substance, to Annex 1 of the BIS IOSCO CCP Recommendations. ICE Trust also covenants to the Commission that information will be available to all ICE Trust Participants regarding the terms of the CDS cleared by ICE Trust, the creditworthiness of ICE Trust or any guarantor, and the clearing and settlement process for CDS cleared by ICE Trust, subject only to such limitations as may be imposed under applicable privacy or similar laws or any protections available under the Freedom of Information Act. ICE Trust understands that an exemptive order

granting ICE Trust relief sought herein would be subject to ICE Trust's compliance with the conditions set out in a Commission exemptive order.

Further, ICE Trust understands that an exemption under Section 17A of the Exchange Act would be subject to compliance with conditions specified in the order, which conditions may include the following:

- i. ICE Trust shall make available on its Web site annual audited financial statements.
- ii. ICE Trust shall keep and preserve at least one copy of all documents, including all correspondence, memoranda, papers, books, notices, accounts, and other such records as shall be made or received by it relating to its CDS clearance and settlement services. These records shall be kept for at least five years and for the first two years shall be held in an easily accessible place.
- iii. ICE Trust shall supply information and periodic reports relating to its CDS clearance and settlement services as may be reasonably requested by the Commission, and shall provide access to the Commission to conduct on-site inspections of all facilities (including automated systems and systems environment), records, and personnel related to ICE Trust's CDS clearance and settlement services.
- iv. ICE Trust shall notify the Commission, on a monthly basis, of any material disciplinary actions taken against any of its members utilizing its CDS clearance and settlement services, including the denial of services, fines, or penalties. ICE Trust shall notify the Commission promptly when ICE Trust involuntarily terminates the membership of an entity that is utilizing ICE Trust's cleared CDS clearance and settlement services. Both notifications shall describe the facts and circumstances that led to the ICE Trust's disciplinary action.
- v. ICE Trust shall notify the Commission of all changes to rules, procedures, and any other material events affecting its CDS clearance and settlement services, including its fee schedule and changes to risk management practices, the day before effectiveness or implementation of such rule changes or, in exigent circumstances, as promptly as reasonably practicable under the circumstances. All such rule changes will be posted on ICE Trust's Web site. Such notifications will not be deemed rule filings that require Commission approval.

- vi. ICE Trust shall provide the Commission with reports prepared by independent audit personnel that are generated in accordance with risk assessment of the areas set forth in the Commission's Automation Review Policy Statements. ICE Trust shall provide the Commission with (beginning in its first year of operation) annual audited financial statements prepared by independent audit personnel.
- vii. ICE Trust shall report all significant systems outages to the Commission. If it appears that the outage may extend for 30 minutes or longer, ICE Trust shall report the systems outage immediately. If it appears that the outage will be resolved in less than 30 minutes, ICE Trust shall report the systems outage within a reasonable time after the outage has been resolved.
- viii. ICE Trust, directly or indirectly, shall make available to the public on terms that are fair and reasonable and not unreasonably discriminatory: (a) all end-of-day settlement prices and any other prices with respect to cleared CDS that ICE Trust may establish to calculate mark-to-market margin requirements for ICE Trust members; and (b) any other pricing or valuation information with respect to cleared CDS as is published or distributed by ICE Trust.

In addition, ICE Trust will only accept CDS for clearance through ICE Trust that meet certain conditions, including that:

- i. The reference entity, the issuer of the reference security, or the reference security is one of the following: an entity reporting under the Exchange Act, providing Securities Act Rule 144A(d)(4) information, or about which financial information is otherwise publicly available; a foreign private issuer whose securities are listed outside the United States and that has its principal trading market outside the United States; a foreign sovereign debt security; an asset-backed security, as defined in Regulation AB, issued in a registered transaction with publicly available distribution reports; an asset-backed security issued or guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae; or independent indexes comprised of these entities or securities, provided that an index will not be disqualified if, in the aggregate, reference entities (or reference securities) comprising 80% or more of the index's weighting satisfy the above information conditions with regard to reference entities or reference securities.

- ii. The CDS is offered and sold only to eligible contract participants, as defined in Section 1a(12) of the Commodity Exchange Act (other than paragraph (C) thereof) as in effect on the date of the order(s) granting the exemptive relief requested herein.

Also, ICE Trust understands that any exemptive relief requested herein would be subject to compliance with conditions specified in the order, which conditions may include the following:

- i. ICE Trust shall report the following information with respect to the calculation of mark-to-market prices for cleared CDS to the Commission within 30 days of the end of each quarter, and preserve such reports during the life of the enterprise and of any successor enterprise: (A) The total dollar volume of transactions executed during the quarter, broken down by reference entity, security, or index; and (B) The total unit volume and/or notional amount executed during the quarter, broken down by reference entity, security, or index; and
- ii. ICE Trust shall establish adequate safeguards and procedures to protect participants' confidential trading information. Such safeguards and procedures shall include: (A) limiting access to the confidential trading information of participants to those employees of ICE Trust who are operating the system or responsible for its compliance with this exemption or any other applicable rules; and (B) implementing standards controlling employees of ICE Trust trading for their own accounts. ICE Trust must adopt and implement adequate oversight procedures to ensure that the safeguards and procedures established pursuant to this condition are followed.

#### V. Conclusion

Based on the foregoing, we respectfully request that the Commission:

- (i) Grant an order pursuant to Exchange Act Section 17A(b)(1), for the avoidance of uncertainty, exempting ICE Trust from any requirement that it register with the Commission as a clearing agency pursuant to Section 17A of the Exchange Act, to the extent otherwise applicable to ICE Trust, on the terms and subject to the conditions described in Section IV.D above of this request;
- (ii) Grant an order pursuant to Exchange Act Section 36(a)(1), for the avoidance of uncertainty, exempting ICE Trust and ICE Trust Participants from any requirement that



they comply with provisions of the Exchange Act governing securities transactions, to the extent otherwise applicable, in connection with the offer, execution, clearance, settlement, performance and related activities contemplated by ICE Trust Rules and this request involving CDS transactions submitted (or executed on terms providing for submission) to ICE Trust for clearance and settlement, subject to the condition that ICE Trust and ICE Trust Participants comply with, and remain subject to, the provisions of the Exchange Act applicable to security-based swap agreements, and on the terms and subject to the conditions described in Section IV.D above of this request; and


(iii) Grant an order pursuant to Section 36(a)(1) of the Exchange Act, for the avoidance of uncertainty, exempting any inter-dealer broker from any requirement that it comply with provisions of the Exchange Act governing securities transactions, to the extent such provisions would otherwise be applicable to such inter-dealer broker, in connection with the effectuation by such inter-dealer broker of CDS transactions submitted to ICE Trust for clearance and settlement, on the terms and subject to the conditions described in Section IV.D of this request.

We believe that the granting of the foregoing exemptive relief will foster an important and much needed innovation in the OTC CDS market that promises many risk mitigating benefits not only for the Participants directly involved but also for other financial market participants and investors generally. Moreover, we believe that these benefits can be provided without prejudicing the interests of any constituency or imposing inappropriate financial or regulatory risks. Accordingly, we believe that the requested relief is appropriate in the public interest and is consistent with the protection of investors.

\* \* \*

If you should have any questions or comments or require further information regarding this request for exemptive relief, please do not hesitate to contact any of the undersigned at (770) 738-2120 . in the case of ICE, and (312) 786-5763, in the case of TCC, or their respective counsel, Abigail Arms of Shearman & Sterling LLP at 202-508-8025 and Edward J. Rosen of Cleary Gottlieb Steen & Hamilton LLP at 212-225-2820.

Very truly yours,



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Johnathan Short  
Senior Vice President & General Counsel  
IntercontinentalExchange, Inc.

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Kevin McClear  
Chief Operating Officer, General Counsel &  
Corporate Secretary  
The Clearing Corporation

cc: Hon. Mary Schapiro  
Hon. Kathleen L. Casey  
Hon. Elisse B. Walter  
Hon. Luis A. Aguilar  
Hon. Troy A. Parades  
Dr. Erik R. Sirri


cc: Abigail Arms, Esq.  
Edward J. Rosen, Esq.

If you should have any questions or comments or require further information regarding this request for exemptive relief, please do not hesitate to contact any of the undersigned at (770) 738-2120, in the case of ICE, and (312) 786-5763, in the case of TCC, or their respective counsel, Abigail Arms of Shearman & Sterling LLP at 202-508-8025 and Edward J. Rosen of Cleary Gottlieb Steen & Hamilton LLP at 212-225-2820.

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Edward J. Rosen, Esq.

## Exhibit Index

<u>Tab</u>	<u>Exhibit</u>	<u>Public Exhibits</u> <u>Item</u>
1.	<b>Public Exhibit 1</b>	Revised Certificate of Merit sent to the NYSBD and the FRBNY on November 7, 2008
2.	<b>Public Exhibit 2</b>	Articles of Organization of ICE US Trust LLC
3.	<b>Public Exhibit 3</b>	Organization chart of ICE Trust
4.	<b>Public Exhibit 4</b>	Schedule of ICE shareholders and ownership