2001 Pennsylvania Avenue NW
Suite 600 I Washington, DC 20006
T 202 466 5460
F 202 296 3184

May 16, 2014

Via Electronic Submission

The Company Secretary
ICE Clear Europe
Milton Gate
5th Floor
60 Chiswell Street
London EC1Y 4SA
United Kingdom

Re: ICE Clear Europe Investment Loss and Non-default Loss Proposal

To Whom It May Concern:

The Futures Industry Association, Inc. ("FIA") appreciates the opportunity to provide ICE Clear Europe ("ICE") with the comments and recommendations set forth below in response to Circular C14/056 on Proposed Changes to the Clearing Rules (the "Proposed Rules"). The Proposed Rules would establish a mechanism whereby ICE would contribute a fixed amount of its own capital (the "ICE Contribution") to cover in whole or in part (a) losses resulting from the default of the issuer or counterparty to an investment of clearing members' guaranty fund contributions or customers' and clearing members' initial margin (collectively, "Investment Losses"), and (b) losses that are not Investment Losses and are unrelated to the default of a clearing member ("Non-default Losses").[1] To the extent that the ICE Contribution is insufficient to cover Investment Losses, ICE proposes to allocate the remaining Investment Losses to its members (each, an "ICE Member" and collectively, "ICE Members") by an assessment on each ICE Member or by offsetting against ICE's obligations to return or pay any margin or guaranty fund contribution ("Collateral Offset Obligation").[2]

I. Interest of FIA in ICE's Proposed Rules[3]

FIA's regular and associate members, their affiliates, and their customers actively participate in ICE's markets as intermediaries, principals and users.[4] FIA represents several members of ICE. Consequently, FIA and its members have a significant interest in

[1] *See* Rule 919(b) of the Proposed Rules
[2] *See* Rule 919(f) of the Proposed Rules
[3] FIA is the leading trade organization for the futures, options and OTC cleared derivatives markets. FIA members are active users of the commodity futures and cleared derivatives transactions markets and include derivatives clearing firms of all sizes as well as leading derivatives exchanges and large commodity firms. Given the variety of enterprises that comprise our regular and associate members, FIA is the only association representative of all organizations that have an interest in the cleared derivatives markets.

any rules that ICE proposes, including rules, such as the Proposed Rules, that relate to the treatment and investment of margin or other property posted to ICE by ICE Members on behalf of their customers (such property, "Customer Property") or on behalf of the ICE Member and its affiliates, including proprietary margin and guaranty fund deposits (such property, "Non-customer Property") and that impact the risk to and liability of ICE Members.

II. Summary of FIA's Comments

Application of the Proposed Rules as they relate to Customer Property would violate certain regulations of the Commodity Futures Trading Commission ("CFTC"). In addition, application of the Proposed Rules as they relate to Non-customer Property would create undue and potentially unlimited and unquantifiable risk for ICE Members. Accordingly, FIA respectfully requests that ICE (i) not adopt the Proposed Rules as drafted and (ii) discuss with FIA and market participants on a holistic approach to address new regulatory requirements on allocation of losses.

III. FIA's Comments

A. Application of the Proposed Rules as they relate to Customer Property would violate certain CFTC regulations.

ICE is a CFTC-registered derivatives clearing organization ("DCO") and, as such, is subject to the jurisdiction of the CFTC and the CFTC regulations when it provides clearing services in relation to certain "Cleared Swaps" as such term is defined in the Commodity Exchange Act, as amended ("CEA").[4] Customer Property posted to ICE by a Futures Commission Merchant ("FCM") to support such customers' Cleared Swaps that are cleared by ICE is governed by Part 22 of the CFTC regulations and constitutes "Cleared Swaps Customer Collateral" as such term is defined in CFTC Rule 22.1. CFTC Rule 22.3(d) permits a DCO to invest Cleared Swaps Customer Collateral in accordance with CFTC Rule 1.25.

CFTC Rule 1.29 governs the treatment of gains and losses resulting from the investment of customer funds by FCMs and DCOs and is made applicable to Cleared Swaps Customer Collateral pursuant to CFTC Rule 22.10. In relevant part, CFTC Rule 1.29(b) states that a DCO shall bear sole responsibility for any losses resulting from the investment of customer funds in instruments described in CFTC Rule 1.25. Any loss allocation mechanism that would make an FCM liable, or ICE not liable, for investment losses related to Customer Property incurred by ICE would clearly violate CFTC Rule 1.29(b). Indeed, CFTC Rule 1.29(b) emphasizes that a DCO is prohibited from allocating losses from investment of customer funds to an FCM where the customer funds are invested by a DCO in its discretion. The language in proposed Rule 1606(b) suggesting that, absent any explicit instruction from an FCM, ICE will invest customer funds in U.S. Treasury securities on the presumption that the FCM is "deemed to have instructed" ICE to do so, does not remove "discretion" (within the meaning of CFTC Rule 1.29(b)) with respect to ICE's investment

[4] CEA section 1a(7)

activities from ICE. FIA suggests that ICE specifically exclude Customer Property from proposed Rule 919 and the definition of 'Investment Losses' in the Proposed Rules.

To the extent that the CFTC determines that the Proposed Rules do not violate CFTC Rule 1.29, then such determination must necessarily be because the loss allocation mechanism under the Proposed Rules is not the allocation of losses on the investment of customer funds. Specifically, the mechanism under proposed Rule 919 for allocation of Investment Losses by ICE to ICE Members would have to be considered a mutualization among ICE Members of losses to ICE's *aggregate* investment portfolio because an ICE Member would share in losses, based on the proportion of aggregate margin and guaranty fund contribution attributable to such ICE Member, to the *overall* investment portfolio rather than losses with respect to a specific ICE Member's or a specific customer's funds.

B. Application of the Proposed Rules as they relate to Non-customer Property would create undue and potentially unlimited and unquantifiable risk for ICE Members.

As a DCO, ICE is permitted to invest Customer Property and Non-customer Property pursuant to CFTC Rule 39.15(e). Whereas CFTC Rule 39.15(e) restricts a DCO's ability to invest Customer Property to those investments permitted under CFTC Rule 1.25, there is not such an explicit restriction with respect to a DCO's investment of Non-customer Property. Rather, CFTC Rule 39.15(e) requires investments of Non-customer Property to be "held in instruments with minimal credit, market and liquidity risks." Without the additional protections provided for in CFTC Rule 1.25, ICE has total discretion over the investments it makes with Non-customer Property. Together with the fact that the Proposed Rules cap ICE's liability for losses, ICE Members would be required to absorb any losses not covered by the ICE Contribution should ICE take undue investment risks.

In order for an ICE Member to fully evaluate the risks associated with the Proposed Rules, the ICE Member would need to understand the risks associated with ICE's investment activities. To the extent that losses from ICE's investment activities may be allocated to ICE Members, ICE must provide ICE Members with detailed reports on (i) investment counterparties, (ii) instruments in which ICE Member's cash is invested, and (iii) total cash investments and amount of each ICE Member's cash invested relative to other ICE Members, so that ICE Members at all times have the ability to calculate capital and track their exposure to underlying investment counterparties. We urge ICE to provide granular information on amount and tenor invested with specific counterparties/instruments, including concentration limits on investment counterparties and instruments (at a minimum, such information should be in line with the Fed PRC disclosure requirement with respect to CCP investments - http://www.newyorkfed.org/prc/files/report_130205.pdf). In addition, the frequency at which information is provided to ICE Members should correspond with the frequency with which ICE can potentially allocate losses to ICE Members, so that the ICE Members can correspondingly track the profits and losses on investments. To this end, disclosure regarding the investment portfolio may be required more frequently than monthly. We understand that ICE has agreed to provide this information to Fed PRC members as part of the Fed PRC CCP transparency disclosure initiative. This disclosure should also include the

type of information an FCM is required to provide to customers regarding material risks pursuant to CFTC Rule 1.55(k)(5). Without adequate disclosure, ICE Members cannot evaluate the potential risk associated with ICE's investment activities and cannot determine whether the ICE Contribution would be adequate to cover any potential loss associated with ICE's investment activities.

For the reasons set forth above, FIA suggests that ICE revise the Proposed Rules as described above and delay implementation until such time as adequate transparency and disclosures can be provided.

C. The Proposed Rules should provide for ICE to contribute an amount of its own capital that is calibrated to increases in the amount and risk of ICE's investment portfolio, and provide for a loss allocation formula that more clearly reflects each ICE Member's contribution to the portfolio.

The Proposed Rules do not include a formula for determining the amount of the ICE Contribution. Our understanding is that ICE plans to dedicate USD 90 million to absorb Non-default Losses and Investment Losses before allocating any remaining Investment Losses to ICE Members. However, the Proposed Rules do not provide any assurance to ICE Members that the ICE Contribution will not be reduced, and does not account for changes in the size or risk profile of ICE's investment portfolio. ICE should have a separate contribution for Investment Losses (rather than a combined contribution for both Non-default Losses and Investment Losses), and the amount of its contribution for Investment Losses should be pre-funded, replenished when used, and scaled up in proportion to the size and risk profile of ICE's investment portfolio under a formula provided in ICE's rulebook. The formula for determining ICE's contribution to cover Investment Losses should be designed to ensure that ICE's contribution is sufficient to cover all Investment Losses under extreme stress scenarios.

In addition, the formula in Rule 919(d) of the Proposed Rules for allocation of losses to each ICE Member should correspond to each ICE Member's actual contribution to ICE's investment portfolio. If ICE's investments are composed solely of cash margin and guaranty fund contributions, the allocation of losses should correspond to each ICE Member's proportionate share of *cash* contribution to the investment portfolio.

D. The Proposed Rules should not permit ICE to offset obligations of ICE Members related to Investment Losses against payment obligations from ICE to ICE Members.

Rule 919(f) of the Proposed Rules states that if Collateral Offset Obligations are due, ICE may offset against the obligation of ICE to return or pay margin or guaranty fund contributions to an ICE Member and/or call for additional cash margin or guaranty fund contribution from a proprietary account of an ICE Member. To the extent ICE requires allocation of Investment Losses to ICE Members, ICE should not be permitted to offset against unrelated obligations of ICE to return margin or guaranty fund contribution. ICE's payment obligations with respect to margin and guaranty fund contribution are unrelated to Investment Losses, and should not be used to cover Investment Losses. Further, Rule 919(f) of the Proposed Rules appears to apply to both payment obligations from ICE to ICE Members and payment obligations from ICE to

customers. To the extent the offset of payment obligations applies to obligations from ICE to customers, Rule 919(f) violates CFTC Rule 1.29(b) as an allocation of losses from the investment of customer funds to customers.

E. ICE should continue to hold its own contributions to each ICE guaranty fund in a separate account or accounts for each contribution

Under existing Rule 1103(e) of the ICE Clear Europe Clearing Rules, ICE undertakes to hold its own contribution ("ICE GF Contribution") to each guaranty fund (i.e., F&O guaranty fund, CDS guaranty fund, and FX guaranty fund) in a separate account or accounts for each such contribution. We are unaware of any regulatory change that would require ICE to remove this provision. We therefore suggest that ICE revise the Proposed Rules to ensure that this provision is not removed.

IV. Conclusion

For the foregoing reasons, FIA respectfully requests that ICE not adopt the Proposed Rules, but instead revise the Proposed Rules overall to reflect the points raised above prior to implementation. If you have any questions, please contact Jacqueline Mesa, Director of International Relations and Strategy, FIA, 202-772-3040 (jmesa@fia.org) or Barbara Wierzynski, General Counsel, FIA, 202-772-3008 (bwierzynski@fia.org).

Respectfully submitted,

Walt L. Lukken
President and Chief Executive Officer

CC: Ananda Radhakrishnan, Director, Commodity Futures Trading Commission, Division of Clearing and Risk