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OFFICE OF THE  
SECRETARY

December 22, 2011

Mr. David Stawick  
Secretary  
Commodity Futures Trading Commission  
1155 21<sup>st</sup> Street, NW  
Washington, DC 20581

## COMMENT

RE: Request from ICE Clear Credit for Order Permitting Portfolio Margining of Commodity-Based Swaps and Security-Based Swaps in a Customer Account (Comment File 1119)

Dear Mr. Stawick:

IntercontinentalExchange, Inc. ("ICE") and ICE Clear Credit LLC ("ICC") appreciate the opportunity to respond to the Commodity Futures Trading Commission ("CFTC") request for public comment upon ICC's Request for an Order Permitting Portfolio Margining of Commodity-Based Swaps and Security-Based Swaps in a Customer Account (the "Request").

As background, ICE operates four regulated futures exchanges: ICE Futures Europe, ICE Futures Canada, the Chicago Climate Exchange, and ICE Futures U.S. ICE also owns and operates five derivatives clearinghouses: ICE Clear U.S., a Derivatives Clearing Organization ("DCO") under the Commodity Exchange Act ("Act"), located in New York and serving the markets of ICE Futures U.S.; ICE Clear Europe, a Recognized Clearing House located in London that serves ICE Futures Europe, ICE's OTC energy markets and operates as ICE's European credit default swaps ("CDS") clearinghouse; ICE Clear Canada, a recognized clearinghouse located in Winnipeg, Manitoba that serves the markets of ICE Futures Canada; The Clearing Corporation, a DCO, and ICC, a U.S.-based DCO and Securities Clearing Agency.

The CFTC is requesting public comment on ICC's Request for an order pursuant to Section 4d(f) of the Act. The Request seeks an order that would set forth terms and conditions under which ICC and its clearing members that are dually registered as futures commission merchants ("FCM") and securities broker-dealers ("BD") would be permitted to (1) hold in a single account subject to Section 4d(f) of the Act (a cleared swaps customer account) positions in commodity-based Credit Default Swaps (Index CDS) and security-based Credit Default Swaps (Single-name CDS) and related customer money, securities and

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IntercontinentalExchange  
2100 RiverEdge Parkway  
Suite 500  
Atlanta, GA 30328  
phone 770 857 4700  
fax 770 951 1307  
online [www.theice.com](http://www.theice.com)



property; and (2) portfolio margin the Index CDS and Single-name CDS held in the cleared swaps customer account.

Customers will benefit from ICC's proposed portfolio margining program through greater capital efficiency due to margin reductions for correlated positions. Unless the relief requested is provided, allowing for the holding in a single account of Index CDS and Single-name CDS assets, BD/FCMs clearing such transactions on behalf of customers will be required to maintain separate customer accounts subject to different margin rules, and will not be able to net customers' offsetting or risk-reducing Index CDS and Single-name CDS positions. Portfolio margining will enable effective cash management by corporate end-users, institutional investors, and financial institutions. Customers will be able to expend fewer resources on margin and will be able to improve their allocation of funds based on their actual risk profile, as more of their assets will be held in a single location with built-in systems to determine the risk of their current portfolio.

Moreover, portfolio margining and holding related instruments in a single account harmonizes the processing and bookkeeping of Index CDS and Single-name CDS in the same production and accounting systems, eliminating the operational risks associated with maintaining separate systems. The incorporation of portfolio margining into ICE Clear Credit's margin methodology, and the holding of Single-name CDS with Index CDS in a single account will help to reduce operational and managerial inefficiencies, substantially enhancing ICE Clear Credit and its clearing members' risk management systems.

#### Confusion Relating to the MF Global Insolvency

The recent insolvency of MF Global, a BD/FCM, may have caused some confusion in the marketplace relating to our Request to hold Index CDS and Single-name CDS in a single account regulated by the CFTC's customer protection rules. The MF Global insolvency has no bearing on our Request. If anything, the MF Global insolvency reinforces the desirability of ICC's proposed one-pot cross margining solution in the event of a BD/FCM insolvency.

The MF Global insolvency event was not caused by a failure of the design of the CFTC's customer segregation laws, but rather, an apparent failure of a BD/FCM to follow the prescribed laws (Section 4d of the Act and CFTC Regulations 1.20-1.30 and 1.32 promulgated thereunder). Failures to observe regulations and potential fraud can occur regardless of what set of regulations are in place. Such failures to abide by the regulations have occurred at regulated banks, funds, BDs, as well as at FCMs. That does not call into question the fundamental principles underlying the Act's Section 4d customer funds segregation regime. Preliminary reports suggest that MF Global may have invaded and misused customer funds that were segregated in the customer account. This type of fraud could also occur with funds held in the 15c3 securities account. In fact, there have been reports that MF Global may have also failed to follow the 15c3 securities account



regulations. CME Chairman, Terry Duffy, discussed the MF Global insolvency event due to the failure to follow prescribed rules in his testimony to Congress on December 15, 2011:

Some might conclude that the system failed because of this one instance when customers have been injured despite the prescribed system of segregation. Regulatory failures happen, unfortunately. Banks fail and the FDIC provides sometimes inadequate protection to depositors. The taxpayers get tapped. Securities firms fail and SIPC is irrelevant to any large account holders. The laws prohibit Ponzi schemes, yet hundreds are detected every year after the public has been robbed and the money evaporated. Insider trading happens every day. Enron explodes, Lehman fails. Insurance companies fail and policy holders lose. While it is clear that action is necessary to restore customer confidence and protect against future failures, *the fact is that MFG broke rules by moving customer segregated funds out of an account over which it had control. A firm failed to comply with applicable rules, but that does not mean the segregation system is a failed system. To be clear, the customer segregation regime in the futures industry was not the cause of the losses that customers are suffering from today.* (Emphasis added.)

#### *Preference for 4d(f) Account Related to Bankruptcy Treatment*

As the MF Global insolvency demonstrated, the bankruptcy administration of an insolvent BD/FCM by a SIPC trustee may result in separate and often uncoordinated resolution of commodity accounts and securities accounts under different timetables and transfer, liquidation, valuation and distribution procedures. Customers would prefer to maintain all of their OTC Cleared derivatives in a single account to avoid different and uncoordinated treatment of their positions in an insolvency proceeding. Many customers that trade CDS also trade other OTC cleared derivatives, which are likely to be commodity derivatives and thus required to be held in a 4d(f) account at an FCM. In the event of a BD/FCM insolvency, a customer would benefit from receiving consistent bankruptcy treatment for its portfolio of correlated Index CDS and Single-name CDS positions as well as other cleared OTC derivatives and associated margin. This is preferred to the potential for inconsistent treatment and dislocations that may occur if its Single-name CDS positions were held in a 15c3 account and subject to one set of bankruptcy rules and procedures, while its other OTC cleared derivatives and futures margin are held in a separate 4d(f) account subject to a different set of bankruptcy rules and procedures.

Maintaining single customer accounts for Index CDS and correlated Single-name CDS in a 4d(f) account provides more protection to customers than if such positions and margin are held in a 15c3 account in the event of a BD/FCM bankruptcy. In the event of a shortfall in customer property, in a FCM bankruptcy customers are afforded priority over general creditors of the FCM with respect to the allocation of the FCM's general assets, as compared to customers of a BD who would share remaining BD property pro-rata with general creditors of the BD.



Under both the Bankruptcy Code and SIPA, in a BD bankruptcy a claim for a shortfall in customer property in a 15c3 securities account shares ratably in the general assets of the BD available for distribution to all creditors.<sup>1</sup> In contrast, under the CFTC's Part 190 rules, in a FCM bankruptcy customers with claims for a shortfall in property in a 4d(f) account have priority over the general creditors of the FCM as to assets available for distribution.<sup>2</sup> Thus, if customer positions and margin were held in a 15c3 securities account, it is likely that in the event of a shortfall in customer property in the securities account, customers would suffer greater losses than if the positions and margin were held in a 4d(f) cleared OTC derivatives customer account.

In the event of a FCM insolvency, in the absence of the ability to arrange a bulk sale or transfer of customer positions, the CFTC's Part 190 rules mandate converting all open commodity contract positions and other customer property, including securities, to cash as early as the filing date or within a short period of time thereafter.<sup>3</sup> This prompt liquidation protects the portfolio margining customer, who is not interested in receiving like-kind securities but rather in minimizing loss in a bankruptcy. In contrast, the SIPA insolvency rules do not appear to provide such assurances of prompt liquidation. In particular, the SIPA trustee may, but has no duty, to liquidate positions promptly.<sup>4</sup>

The CFTC Part 190 rules generally are detailed and precise regarding the procedure for liquidating customer property held in customer commodity 4d(f) accounts. The BD/SIPA insolvency rules are more general, and with respect to the liquidation of commodity contracts in particular, do not appear to provide any specific guidance. For example, it is not clear whether a person would be considered a "customer" under SIPA for claims with respect to assets other than securities in a securities account, such as commodity swaps margin or positions. If a person were not considered a "customer" for these purposes, the person would risk being deemed a general creditor of the BD with respect to the commodity swap positions and margin. Such a person would fall behind all other securities customers and would be diluted by general creditors for its entire Index CDS claim.

Within the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), Congress discusses the SEC granting an exemption permitting securities, including security-based swaps (Single-name CDS), to be held by a dually registered BD/FCM in a 4d(f) portfolio margining account subject to the commodity broker liquidation rules, pursuant to a portfolio margining program approved by the CFTC.<sup>5</sup> The CFTC is required by Dodd-

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<sup>1</sup> 11 USC 752(b)(2)

<sup>2</sup> 17 CFR 190.08 (a)(1)(I)(J) and (b)

<sup>3</sup> Appendix A to Part 190

<sup>4</sup> 15 USC 78fff-1(b)

<sup>5</sup> Dodd-Frank Act Section 713(a)



Frank to treat Single-name CDS held in a 4d(f) account as customer property and subject to the commodity broker liquidation rules.<sup>6</sup>

By comparison, it is less clear whether Dodd-Frank authorizes commodity swaps (Index CDS) to be held in a securities account, or how they are to be treated.<sup>7</sup> In the absence of clarity on this point, again, there is a potential risk that a person would not be considered to be a “customer” under SIPA for claims with respect to assets other than securities, such as Index CDS margin or positions, carried in a securities account. As noted above, if a person were not considered a “customer” for these purposes, the person would risk being deemed a general creditor of the BD with respect to Index CDS positions and margin.

#### *Why ICC did not Petition for Customer Choice*

ICC analyzed both the 4d(f) and 15c3 accounts and worked closely with buy-side customers before submitting our Request to portfolio margin and maintain both Index CDS and Single-name CDS positions in the 4d(f) account. ICC determined through this analysis and work with customers that portfolio margining Index CDS and Single-name CDS positions in the 4d(f) account provided the most efficient and secure solution for customers. In discussions with customers, ICC received no indication that a choice to combine positions in a 15c3 securities account was desired. Accordingly, ICC’s Request only seeks relief with respect to the portfolio margining customer positions in the 4d(f) account.

In addition, providing CDS customers the choice to hold CDS positions in either a 4d(f) or 15c3 account would require extensive operational and bookkeeping work and costs at both the BD/FCMs and ICC. These costs which would eventually be transferred to customers as increased fees incurred to provide an option that customers do not need and have not requested. The requirement to offer an account structure option would require significant operational and administrative changes at ICC and each of its participant BD/FCMs. This would involve changes to trade processing systems (to designate account type), risk management processes (to capture and relate positions and margin held in multiple account types), treasury as well as banking processes, systems and accounts. The required changes would result in increased significant initial and ongoing costs and inefficiencies and would require time to implement.

The ICC Request seeks to reduce and simplify the number of necessary bank accounts, related banking transactions and money flows. Requiring a choice will require ICC and its BD/FCMs to manage two different account types and will add the additional operational burden of tracking which customers have elected which account. The costs of requiring ICC and BD/FCMs to offer a choice that is not desired by customers greatly outweigh any benefits of such choice.

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<sup>6</sup> Dodd-Frank Act Section 713(c)

<sup>7</sup> Dodd-Frank Act Section 713(b)



It is our understanding that when customers were provided with a choice between 15c3 and 4d accounts, in the case of security futures products, customers overwhelmingly (if not unanimously) chose to maintain their security futures positions and margin in a 4d account.

### *Conclusion*

ICC carefully analyzed both the 4d(f) and 15c3 accounts and related rules and determined that maintaining single-customer accounts for Index CDS and correlated Single-name CDS in a 4d(f) account provides more certainty and protection to customers than if such positions and margin are held in a 15c3 account in the event of a BD/FCM bankruptcy. ICC worked closely with customers who expressed that portfolio margining Index CDS and Single-name CDS positions in the 4d(f) account provided the most desirable solution and received no indication from customers that a choice to also combine Index CDS and Single-name CDS in a 15c3 securities account was desired. Furthermore, maintaining two separate "choice" regimes would be overly burdensome to ICC and its BD/FCM clearing participants from a cost and operationally perspective and would lead to confusion and uncertainty in the event of a BD/FCM bankruptcy.

We appreciate the opportunity to comment upon ICE Clear Credit's Request for an Order Permitting Portfolio Margining of Swaps and Single-name Swaps in a Customer Account. If you have any questions, please contact the undersigned at (312) 836-6810 or Kevin McClear, General Counsel, at (312) 836-6833.

Sincerely,

A handwritten signature in black ink, appearing to read "Christopher S. Edmonds", written in a cursive style.

Christopher S. Edmonds  
President  
ICE Clear Credit LLC