



DIVISION OF  
TRADING AND MARKETS

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

April 22, 2013

Mr. Christopher Edmonds  
President  
ICE Clear Credit LLC  
353 North Clark Street  
Suite 3100  
Chicago, IL 60654

Dear Mr. Edmonds:

This responds to questions concerning the margin treatment of certain cleared credit default swap (“CDS”) portfolios that have been raised to you by various clearing participants of ICE Clear Credit LLC (“ICE Clear Credit”) and other market participants.

Background

On December 14, 2012, the Securities and Exchange Commission (“Commission”) issued an order (“Order”) granting conditional exemptive relief from compliance with certain provisions of the Securities Exchange Act of 1934 (“Exchange Act”) in connection with a program to commingle and portfolio margin customer positions in cleared CDS that include both swaps and security-based swaps in a segregated account established and maintained in accordance with Commodity Exchange Act (“CEA”) Section 4d(f) (“CDS portfolio margin program”). The exemptive relief granted in the Order is subject to certain conditions, including the requirement that a dually-registered broker-dealer and futures commission merchant (“BD/FCM”) operating pursuant to the Order must set minimum margin levels with respect to any customer transaction in the CDS portfolio margin program at least equal to the amount determined using a margin methodology established and maintained by the BD/FCM that has been approved in writing by the Commission or its staff. The Order also stated that in appropriate circumstances the Commission or the Commission staff may provide temporary approval of a BD/FCM’s margin methodology while the methodology is still being evaluated prior to granting final approval.

Based on the Commission staff’s review of information submitted by seven BD/FCMs, on March 8, 2013, the Commission staff issued letters to those firms to temporarily permit them to calculate portfolio margin amounts for customer positions in commingled CDS that are security-based swaps and swaps using a model (“ICE Model”) developed by ICE Clear Credit,

Mr. Christopher Edmonds

April 22, 2013

Page 2

augmented by applying a multiplier to the margin amount calculated by the ICE Model and in some cases a capital charge to act as additional buffers of safety.<sup>1</sup> These letters reflect an interim approach, while the Commission continues review of the margin methodologies and risk controls of the individual firms and continues discussion with representatives of ICE Clear Credit concerning the operation of its margin model as it relates to customer portfolios.

### Questions and Answers

You represent that ICE Clear Credit clearing participants and other market participants have raised certain questions since the Commission staff issued the conditional temporary approval letters described above. These questions and the Commission staff's responses, which apply only to the extent the conditional temporary approval letters remain effective, are set forth below:

**Question 1:** **What is the margin treatment of a portfolio containing only single-name CDS positions?** You state that a cleared portfolio of a client (a "Client") of a clearing participant may consist solely of single-name CDS positions. This may be the case at all times, or only at certain times as index CDS positions are bought and sold. The Commission's Order, as well as the Commodity Futures Trading Commission's ("CFTC") order,<sup>2</sup> would appear to permit such single-name positions to be held or continue to be held in a CEA Section 4d(f) account. Based on your understanding, it is not clear to market participants what margin requirement would apply to such positions, as technically, the single-name CDS positions are not being portfolio margined with index CDS positions.

**Answer:** A Client account at a BD/FCM that holds at all times only single-name CDS positions would be subject to applicable margin requirements under FINRA Rule 4240. A Client account that holds at various times both single-name and index CDS positions is subject to the margin requirements of the Commission's

---

<sup>1</sup> Recipients of the seven letters were: Goldman, Sachs & Co., Morgan Stanley & Co. LLC, UBS Securities LLC, Barclays Capital Inc., J.P. Morgan Securities LLC, Credit Suisse Securities (USA) LLC, and Citigroup Global Markets Inc. In general, the letters temporarily approve a margin methodology under which the BD/FCMs collect a margin amount from a CDS customer at least equal to 200% of the amount calculated using the ICE Model. A BD/FCM, however, may collect an amount from each customer at least equal to 150% of the amount calculated by the ICE Model provided the customer has virtually no credit risk (based on the firm's internal credit rating scale). Finally, BD/FCMs would have the option of only collecting margin equal to 100% of the amount calculated by the ICE Model, provided the firm takes a 100% capital charge in an amount equal to the difference between the required margin amount and the amount of margin collected.

<sup>2</sup> On January 14, 2013, the CFTC issued a complementary order specific to ICE Clear Credit permitting ICE Clear Credit and its participants to hold customer property used to margin, guarantee, or secure positions in cleared security-based swaps and cleared swaps in a Section 4d(f) account and to provide for portfolio margining of such cleared swaps and cleared security-based swaps. The CFTC's complementary order is available on the internet at <http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/icecreditclearorder011413.pdf>.

Order. The use of the clearing house methodology as allowed by FINRA Rule 4240 presumes the BD/FCM employs risk monitoring procedures and guidelines to monitor its credit exposure.

**Question 2: What is the margin treatment of a portfolio solely consisting of indices or a portfolio that no longer contains single-name CDS?** You indicate that: (1) a Client may have a portfolio that solely consists of index CDS positions; or (2) a Client that has a cleared portfolio including index and single-name CDS, which is being portfolio margined subject to the 200% requirement, may at some point sell or unwind the single-name CDS positions, such that the portfolio only contains index CDS positions. In either case, market participants assume that the 200% requirement would no longer apply (at least until such time as single-name CDS positions are added to the portfolio).

**Answer:** Subject to the answer to question 3 below, a Client account at a BD/FCM that holds at all times only index CDS positions would be subject to the margin requirements applicable to CEA Section 4d(f) accounts. A Client account that holds at various times both single-name and index CDS positions is subject to the margin requirements of the Commission's Order.

**Question 3: What is the margin treatment of portfolios containing spun-out restructuring positions?** You also state that an index CDS position may, in the case of a restructuring credit event with respect to a component of the index, result in the creation or "spin-out" of a single-name CDS on that component. The single-name is "spun-out" solely for the purpose of facilitating the triggering process in DTCC. In situations where the "spun-out" single-name is triggered, the "spun-out" position is terminated shortly after the auction is concluded. If a Client's portfolio solely consists of index CDS positions, other than the spun-out single-name, market participants have questioned whether the 200% requirement would apply to the entire portfolio.

**Answer:** A Client account at a BD/FCM that holds at all times only index CDS positions and single-name CDS positions that arose from index CDS positions in the account at the time of a spin-out from those index positions would be subject to the margin requirements applicable to CEA Section 4d(f) accounts. The size of the resulting spun-out single-name CDS position cannot be increased.

**Question 4: What is the margin treatment of clearing participants' affiliates?** Under the Commission's Order, single-name CDS positions of affiliates of clearing participants are permitted to be held as proprietary, rather than as customer positions, consistent with the treatment of such positions under CFTC rules. Market participants have suggested that such positions should therefore also be subject to proprietary margin levels (i.e., clearinghouse minimum requirements), rather than the 200% requirement.

Mr. Christopher Edmonds

April 22, 2013

Page 4

**Answer:** Consistent with the treatment of affiliates under the Commission's and FINRA's broker-dealer financial responsibility rules, a BD/FCM that is a clearing participant must treat its affiliates' single-name CDS positions as customer positions for margin purposes.

The positions set forth above were prepared by and represent the views of the Commission staff. They are not rules, regulations, or statements of the Commission, and do not have the approval or disapproval of the Commission. These positions are subject to modification or revocation if at any time the Commission or Commission staff determines that such action is necessary or appropriate in furtherance of the purposes of the Exchange Act.

If you have any questions, please do not hesitate to contact me at (202) 551-5525.

Sincerely,

A handwritten signature in cursive script, appearing to read "Michael Macchiaroli".

Michael A. Macchiaroli  
Associate Director