



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

June 5, 2009

Paul E. Glotzer, Esq.
Cleary Gottlieb Steen & Hamilton LLP
One Liberty Plaza
New York, New York 10006

Dear Mr. Glotzer:

This is in response to the request by Cleary Gottlieb Steen & Hamilton LLP, on behalf of certain participants in ICE US Trust LLC (“ICE Trust”), New York, New York, for a determination of the appropriate risk weights that should apply to claims on ICE Trust.¹ Specifically, you request that a zero percent risk weight under the risk-based measure of the Board’s Capital Adequacy Guidelines for state member banks and bank holding companies (“Risk-Based Capital Rules”)² be assigned to (1) the counterparty credit risk charge on credit default swap (“CDS”) transactions with ICE Trust, and (2) funds placed with ICE Trust as part of ICE Trust’s guarantee fund (“GF Contributions”) or as additional margin (“Margin”).

On March 4, 2009, the Board approved the application by ICE Trust to become an uninsured state member bank³ that will provide central counterparty services by clearing certain CDS contracts among its participants. As a central counterparty and clearinghouse for CDS trades of its participants, ICE Trust will use a novation process whereby the original contract between buyer and seller is extinguished and replaced by two new contracts, one between ICE Trust and the buyer and the other between ICE Trust and the seller. In addition to the netting of CDS transactions, ICE Trust will collect (i) Margin, which consists of (a) daily

¹ Current participants in ICE Trust are major dealers, including Bank of America, N.A.; Goldman Sachs International; Barclays Bank PLC; Citibank, N.A.; Credit Suisse International; Deutsche Bank AG, London Branch; JPMorgan Chase Bank, N.A.; Merrill Lynch International; Morgan Stanley Capital Services, Inc.; and UBS AG.

² 12 CFR parts 208 and 225, Appendix A.

³ ICE US Trust LLC (Board order, March 4, 2009).

two-way cash-variation margin and (b) 99 percent 5-day Value-at-Risk (“VaR”)-based initial margin, and (ii) 99.999999 percent VaR-based GF Contributions that will provide additional protection against the default of a major market participant. ICE Trust has established practices to mitigate the risks to participants, including the netting of offsetting trades, the daily payment and receipt of cash-variation margin, the payment of initial margin, strict standards for participants, and strong risk management.⁴ Margin and GF Contributions effectively function as collateral that is available to support the obligations of ICE Trust. Likewise, ICE Trust can demand supplemental margin from a participant on an intraday basis or increase the size of a participant’s GF Contributions at its own discretion, if warranted, to protect itself and the other participants. ICE Trust is subject to direct supervision by the Federal Reserve and the New York State Banking Department.

Under the Risk-Based Capital Rules, exposures to insured banks, other insured depository institutions, and qualifying securities firms are assigned a 20 percent risk weight, whereas exposures to other companies generally receive a 100 percent risk weight.⁵ ICE Trust is an uninsured state-chartered trust company; therefore, direct exposures to ICE Trust, including both Margin and GF Contributions, ordinarily would be risk weighted at 100 percent under the Risk-Based Capital Rules. The risk weight for the counterparty credit risk on the CDS exposures to ICE Trust would be 50 percent.⁶ However, if ICE Trust were an insured depository institution or a qualifying securities firm, a 20 percent risk weight would apply to both the CDS transactions and the direct exposures. Further, under the Risk-Based Capital Rules, derivative transactions traded on exchanges that require daily payment and receipt of cash-variation margin may be excluded from the risk-based capital requirements, although direct exposures to such exchanges would be risk weighted at 100 percent.⁷

⁴ Participants are required to demonstrate sufficient financial resources, operational capabilities, and risk-management experience under strict guidelines (e.g., \$5 billion or greater tangible net worth, a minimum long-term debt rating of “A,” and a \$20 million minimum contribution to ICE Trust’s guarantee fund).

⁵ 12 CFR parts 208 and 225, Appendix A, sections III.C.2. and III.C.4.

⁶ The risk weight for counterparty credit risk for derivative exposures is capped at 50 percent. 12 CFR parts 208 and 225, Appendix A, section III.E.4.

⁷ 12 CFR parts 208 and 225, Appendix A, section III.E.1.e.

Under the Basel II advanced approaches rules of the Board's Capital Adequacy Guidelines ("advanced approaches rules"), a banking organization may attribute an exposure at default of zero to outstanding derivative transactions with a qualifying central counterparty ("QCC"), as well as to clearing deposits and posted collateral that arise from the derivative transactions, which is equivalent to applying a zero percent risk weight to the exposures.⁸ The Basel Committee on Banking Supervision has indicated it will be revisiting this treatment as part of its current workplan.

The Board has broad authority to provide exemptions from the Risk-Based Capital Rules and the advanced approaches rules on a case-by-case basis.⁹

Based on all the facts of record, including the information provided in your request and other supervisory information, the Board believes that it would be appropriate to allow current participants in ICE Trust (and their top-tier bank holding companies) to apply a 20 percent risk weight under the Risk-Based Capital Rules to claims on ICE Trust, including counterparty credit risk of the CDS exposures cleared through ICE Trust and claims in the form of Margin and GF Contributions, for the first-quarter reporting period of 2009 and for subsequent reporting periods. A 20 percent risk weight for such claims on ICE Trust is appropriate because the risks ICE Trust poses to counterparties are not materially different than those posed by other U.S. depository institutions, as well as by banks in countries that are members of the Organisation for Economic Co-operation and Development ("OECD banks"). Claims on OECD banks are also risk weighted at 20 percent.

This treatment is further supported by the high degree of risk mitigation afforded by ICE Trust's practices (e.g., netting of offsetting trades, the daily payment and receipt of cash-variation margin, the payment of initial margin, strict standards for participants, and strong risk management) and the fact that ICE Trust is subject to direct oversight by the Federal Reserve and the New York State Banking Department. In addition, most of the current participants are entities that

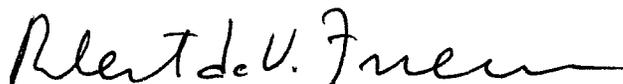
⁸ See 12 CFR part 208, Appendix F; 12 CFR part 225, Appendix G. A QCC must facilitate trades between counterparties in one or more financial markets by either guaranteeing trades or novating contracts, must require all participants to be fully collateralized on a daily basis, and must be in sound financial condition and subject to effective oversight by a national supervisory authority.

⁹ 12 CFR parts 208 and 225, Appendix A, section III.A.

qualify directly for a 20 percent risk weight. Exposures to ICE Trust in the form of Margin and GF Contributions are not materially riskier than exposures to the participants themselves, and the exposures to ICE Trust, therefore, need not be subject to higher risk weights. Although the Board believes that a 20 percent risk weight for claims on ICE Trust is appropriate under the circumstances, the Board might in the future impose a risk-based capital treatment for clearinghouse arrangements, including claims on ICE Trust, that differs from the treatment provided under this exemption.

This determination is specifically conditioned on compliance by ICE Trust participants with all the commitments and representations made to the Board in connection with their request. These commitments and representations are deemed to be conditions imposed in writing by the Board in connection with granting the request and, as such, may be enforced in proceedings under applicable law. This determination is also based on the specific facts and circumstances of the existing relationship between ICE Trust and the participants. Any material change in those facts or circumstances or any failure by participants to observe any of their commitments or representations may result in a different determination or in revocation of the exemption.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Robert deV. Frierson". The signature is fluid and cursive, with a long horizontal stroke at the end.

Robert deV. Frierson
Deputy Secretary of the Board

cc: Ivan Hurwitz, Vice President
Federal Reserve Bank of New York
New York State Banking Department
Office of the Comptroller of the Currency