



U.S. COMMODITY FUTURES TRADING COMMISSION

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Division of Clearing and Risk

Ananda Radhakrishnan
Director

CFTC Letter No. 14-123
No-Action; Exemption
October 8, 2014
Division of Clearing and Risk

Mr. Paul Swann
President and Managing Director
ICE Clear Europe Limited
60 Chiswell Street
London EC1Y 4SA

RE: Request for No-Action Relief from the Written Acknowledgment Requirements in Commission Regulation 1.20(g)(4); Request for Interpretation or, in the alternative, Exemptive or No-Action Relief with regard to Commission Regulation 1.49(d)(3)

Dear Mr. Swann:

This is in response to your letter dated September 22, 2014 (“Letter”), to the Division of Clearing and Risk (“Division”) of the Commodity Futures Trading Commission (“Commission”). In the Letter, you request that the Division confirm that it will not recommend that the Commission take enforcement action against ICE Clear Europe Limited (“ICE”) for failing to obtain, or provide the Commission with, an executed version of the template acknowledgment letter set forth in Appendix B to Regulation 1.20 (“Template Acknowledgment Letter”), as required by Regulation 1.20(g)(4), for customer accounts maintained at the Bank of England (“BoE”). You additionally request that the Division confirm that the BoE is a qualified depository for customer funds under Regulation 1.49(d)(3)(i) or, in the alternative, absent such confirmation, that the Division grant either exemptive or no-action relief with respect to ICE’s holding of customer funds at the BoE.

I. No-Action Relief from the Written Acknowledgment Requirements in Commission Regulation 1.20(g)(4)

Regulation 1.20(g)(4) requires, among other things, that a derivatives clearing organization (“DCO”) obtain a Template Acknowledgment Letter from each depository with

which the DCO deposits futures customer funds.¹ DCOs were required to obtain Template Acknowledgment Letters for existing customer segregated accounts by July 12, 2014.² By letter dated July 3, 2014 (“Extension Request”), ICE informed the Division that the BoE, a depository with which ICE seeks to maintain customer accounts, had indicated that it required certain modifications to the Template Acknowledgment Letter. To allow for discussions between the Division and the BoE regarding a mutually acceptable version of the Template Acknowledgment Letter that the BoE would execute with ICE (“BoE Acknowledgment Letter”), ICE requested an extension of time to comply with Regulation 1.20(g)(4), and represented that it would, upon the conclusion of the Division’s discussions with the BoE, submit a separate request for relief to use the BoE Acknowledgment Letter. In response, the Division granted a temporary extension of the compliance deadline to ICE.³

A. Statement of Facts

The Division understands the relevant facts to be as follows:

In addition to its registration with the Commission as a DCO, ICE is a Recognised Clearing House in the United Kingdom (“U.K.”), subject to the direct supervisory oversight of the BoE. As the U.K.’s central bank, the BoE is the issuer of the U.K. currency and is the lender of last resort to the U.K. banking system. As a chartered corporation established by statute, the BoE lies outside of the U.K. insolvency regime and, thus, cannot be wound up or made insolvent except by Act of Parliament.

ICE seeks to maintain accounts at the BoE into which ICE may deposit futures customer funds. In this regard, the BoE has indicated to ICE that it requires certain modifications to the Template Acknowledgment Letter associated with such accounts.

B. Discussion of Request for No-Action Relief and Applicable Legal Requirements

The Commission notes that the BoE is a central bank for a money center country, which the Commission has recognized as a permissible location for a depository holding customer funds.⁴ The Commission further notes that, as a central bank, the BoE’s provision of account services to ICE is distinguishable from the provision of account services by a commercial bank. In adopting the Template Acknowledgment Letter requirements, the Commission explicitly

¹ See Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations, 78 Fed. Reg. 68,506 (Nov. 14, 2013).

² *Id.* at 68,578 (setting forth the compliance date for Regulation 1.20).

³ See CFTC Letter No. 14-93 (July 10, 2014) (granting time-limited relief, set to expire the earlier of 90 days from the issuance of such relief, or the date on which the Division responds to ICE’s subsequent request for relief (*i.e.*, the Letter, as referred to herein) to use the BoE Acknowledgment Letter).

⁴ See Regulation 1.49(a)(1) (defining “money center country”).

recognized the “unique role of the Federal Reserve Bank” in excluding Federal Reserve Banks, when providing account services, from the requirement that depositories accepting customer funds from DCOs execute a Template Acknowledgment Letter.⁵ In this regard, under Regulation 1.20(g)(4)(ii), a Federal Reserve Bank acting as a depository for customer funds need only provide “a written acknowledgement that (A) The Federal Reserve Bank was informed that the customer funds deposited therein are those of customers . . . and are being held in accordance with the provisions of section 4d of the Commodity Exchange Act and Commission regulations thereunder; and (B) The Federal Reserve Bank agrees to reply promptly and directly to any request from [Commission staff] for confirmation of account balances or provision of any other information regarding or related to an account.”⁶

The Division further notes that both Title VIII of the Dodd-Frank Act and the CPSS-IOSCO Principles for Financial Market Infrastructures (“PFMIs”)⁷ support central banks acting as depositories for customer funds, due to certain favorable policy considerations. The BoE, in its capacity as a central bank for a money center country, does not present the same types of risks as traditional commercial banks, as it serves in the public interest and operates with the goal of maintaining stability in the financial markets. Further, deposits at a central bank have the lowest credit risk and are the source of liquidity with regard to their currency of issue;⁸ ICE would, therefore, face much lower credit and liquidity risk with a deposit at the BoE than it would with a deposit at a commercial bank. Thus, granting the relief requested is appropriate to permit ICE to maintain customer accounts at the BoE.

In addition, the Commission had contemplated the possibility that foreign depositories might require modifications to the Template Acknowledgment Letter in certain situations, in which case “the Commission would consider alternative approaches, including no-action relief, on a case-by-case basis.”⁹ In light of the above, the Division has had discussions with the BoE regarding a mutually acceptable version of the Template Acknowledgment Letter, *i.e.*, the BoE Acknowledgment Letter, set forth in an attachment to this letter.

⁵ See 78 Fed. Reg. at 68,535.

⁶ 17 C.F.R. § 1.20(g)(4)(ii).

⁷ The PFMIs are a set of international risk management standards for financial market infrastructures, including DCOs, which have been adopted and implemented by many jurisdictions.

⁸ See PFMIs, ¶ 3.9.3 (noting that “[c]entral banks have the lowest credit risk and are the source of liquidity with regard to their currency of issue”); see also PFMIs, Key Consideration 8 (specifying that a financial market infrastructure “with access to central bank accounts, payment services, or securities services should use these services, where practical, to enhance its management of liquidity risk,” which is consistent with the standards set forth in section 806(a) of the Dodd-Frank Act, authorizing accounts at a Federal Reserve Bank for designated financial market utilities). See 12 U.S.C. § 5465(a).

⁹ 78 Fed. Reg. at 68,536.

C. Terms and Conditions set forth in the BoE Acknowledgment Letter

The BoE Acknowledgment Letter incorporates provisions of the Template Acknowledgment Letter and the written acknowledgment requirements applicable to Federal Reserve Banks set forth in Regulation 1.20(g)(4)(ii), and includes certain provisions that are specific to the customer accounts maintained at the BoE. Specifically, paragraph 1 of the BoE Acknowledgment Letter identifies the subject matter of the letter and makes no substantive change to the first paragraph of the Template Acknowledgment Letter. Paragraph 2 of the BoE Acknowledgment Letter is consistent with the first clause of paragraph 2 of the Template Acknowledgment Letter, in stating that ICE has informed the BoE that it has opened the account for the purpose of depositing customer funds, as required by Commission regulations. This paragraph, when read in conjunction with paragraph 3 of the BoE Acknowledgment Letter, encompasses the substance of Regulation 1.20(g)(4)(ii)(A), which is applicable to acknowledgment letters obtained from a Federal Reserve Bank.

Paragraph 3 of the BoE Acknowledgment Letter is consistent with the second and third clauses of paragraph 2 of the Template Acknowledgment Letter and, as noted above, when read in conjunction with paragraph 2 of the BoE Acknowledgment Letter, encompasses the substance of Regulation 1.20(g)(4)(ii)(A). Paragraph 4 of the BoE Acknowledgment Letter refers to a provision in the account agreement between ICE and BoE (“Account Agreement”) in which the BoE waived its right of set off against the account. This provision addresses the concerns addressed by paragraph 3 of the Template Acknowledgment Letter.

Consistent with paragraph 4 of the Template Acknowledgment Letter and Regulation 1.20(g)(4)(ii)(B), paragraph 5 of the BoE Acknowledgment Letter provides that the BoE will, as soon as reasonably practicable, reply to any request for confirmation of account balances or provision of any other information regarding or related to the account from the Division or the Division of Swap Dealer and Intermediary Oversight. This provision deviates from the language of Regulation 1.20(g)(4)(ii)(B) in one respect, *i.e.*, the BoE is to provide a response “as soon as reasonably practicable” rather than “promptly.” This change is intended to take into account such circumstances as time zone differences and U.K. bank holidays which could impact the timing of the BoE’s response.

Paragraph 6 of the BoE Acknowledgment Letter is derived from paragraph 6 of the Template Acknowledgment Letter, in that ICE will not hold the BoE responsible for acting pursuant to Commission inquiries in paragraph 5. Finally, paragraph 7 of the BoE Acknowledgment Letter clarifies that except for the BoE’s commitment to respond to Commission inquiries in paragraph 5, the BoE Acknowledgment Letter is not intended to amend the Account Agreement. This provision also acknowledges that the BoE is not making any representations as to ICE’s representations in the BoE Acknowledgment Letter, *e.g.*, the funds in the account are customer funds and ICE is treating them in accordance with Section 4d of the Commodity Exchange Act (“CEA”).

D. Grant of No-Action Relief

Based on the facts presented and the representations ICE has made, the Division will not recommend that the Commission take enforcement action against ICE for executing, and submitting to the Commission, the BoE Acknowledgment Letter, in place of the Template Acknowledgment Letter. For any customer account opened by ICE with the BoE prior to or as of the date of this letter, ICE and the BoE must execute and submit to the Commission (within three days of execution), the BoE Acknowledgment Letter; this process shall be completed no later than December 1, 2014. The issuance of this no-action letter hereby terminates the relief provided in response to the Extension Request.¹⁰

The position taken herein concerns enforcement action only and does not represent a legal conclusion with respect to the applicability of any provision of the CEA or the Commission's regulations. As with all no-action relief, the Division retains the authority to condition further, modify, suspend, terminate, or otherwise restrict the terms of the no-action relief provided herein, in its discretion.

II. Exemptive Relief from the Requirements of Commission Regulation 1.49(d)(3)

In the context of maintaining customer accounts at the BoE, ICE has requested that the Division confirm that the BoE is a qualified depository for customer funds under Regulation 1.49(d)(3)(i) or, in the alternative, absent such confirmation, that the Division grant exemptive or no-action relief to permit ICE to hold customer funds at the BoE. Regulation 1.49(d)(3) provides that, in order to hold customer funds with a depository located outside of the United States, the depository must be: (i) a bank or trust company that has in excess of \$1 billion of regulatory capital, (ii) a registered futures commission merchant, or (iii) a DCO.¹¹ The Division finds that Regulation 1.49(d)(3)(i) unintentionally precludes the BoE from acting as a depository for customer funds, notwithstanding that it is a central bank for a money center country, because the BoE cannot satisfy the regulatory capital requirement. Nonetheless, based on the following analysis, the Division is granting an exemption to ICE from the requirements of Regulation 1.49(d)(3).

In adopting Regulation 1.49, the Commission sought to address the various types of risks that arise in the context of holding customer funds with a depository. In requiring that a non-U.S. bank or trust company have at least \$1 billion in regulatory capital, the Commission sought to ensure that customer funds would not be deposited with a small commercial bank or trust company, which, because of its size, would be unlikely to have the financial or operational resources to adequately administer customer accounts. The \$1 billion regulatory capital

¹⁰ See CFTC Letter No. 14-93 (July 10, 2014) (granting a temporary extension of the compliance deadline for Regulation 1.20(g)(4) to allow for continued discussions between the Division staff and the staff of the BoE.

¹¹ 17 C.F.R. § 1.49(d)(3).

requirement, therefore, serves as a proxy for a bank or trust company's suitability as a depository for customer funds, both in terms of financial strength and operational sophistication. The BoE, while it has adequate financial and operational resources to properly handle customer funds,¹² does not technically satisfy the \$1 billion *regulatory* capital requirement. Regulatory capital consists of the capital required pursuant to a depository's regulatory regime, and is typically composed of Tier 1 capital (*i.e.*, common stock). Unlike commercial banks, central banks, like the BoE, are not held to regulatory capital requirements. Therefore, because the BoE does not, by definition, satisfy the requirements of Regulation 1.49(d)(3)(i), the Division finds that an exemption is appropriate to address the preclusive effect of the regulation's plain meaning.

The Division notes that Section 4d of the CEA, which establishes segregation requirements for futures and cleared swaps customer funds, similarly refers to "a bank or trust company" or "any depository institution," without distinguishing between a commercial or central bank, a large or small depository, or a depository located in the United States or in a foreign country.¹³ In addition, Regulation 1.49(c)(1)(ii) permits customer funds to be held in a depository located in the United Kingdom.¹⁴ Section 4d of the CEA and Regulation 1.49(c)(1)(ii) can be read to permit the BoE to act as a depository for customer funds; however, Regulation 1.49(d)(3)(i), in its reference to *regulatory* capital, precludes the BoE in this regard.

As discussed in greater detail above, there are distinct financial safeguards afforded by holding customer funds at the BoE, as a central bank for a money center country, that merit an exemption in this regard.¹⁵ Based on the foregoing, pursuant to delegated authority from the Commission, the Division hereby grants an exemption to ICE from the requirements of Regulation 1.49(d)(3) to permit ICE to hold customer funds at the BoE. The Division believes that granting the relief would not be contrary to the public interest or to the purposes of Regulation 1.49(d)(3).

¹² The BoE's Banking Department has over \$1 billion in capital and reserves. *See* BoE Annual Report (2014), available at <http://www.bankofengland.co.uk/publications/Documents/annualreport/2014/boereport.pdf>.

¹³ 7 U.S.C. § 6d. Additionally, Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), in permitting systemically important DCOs to deposit customer funds at Federal Reserve Banks, thereby subjects the Federal Reserve Banks to compliance with the segregation requirements of Section 4d of the CEA. *See* Dodd-Frank Act, Pub. L. No. 111-203, 124. Stat. 1376 (2010).

¹⁴ Regulation 1.49(c)(1)(ii) provides that customer funds may be held in a depository located in a money center country, which is defined to include the United Kingdom. *See* Regulation 1.49(a)(1) (defining "money center country").

¹⁵ *See* discussion *supra* Part I.B. (emphasizing the favorable policy considerations of holding customer funds at a central bank, as supported by Title VIII of the Dodd-Frank Act and the PFMI). The Division further notes that Regulation 1.49(d)(3) has not been updated to align with Title VIII of the Dodd-Frank Act, nor with the standards set forth in the PFMI.

III. Conclusion

This letter is based upon the representations of ICE and applicable laws and regulations in their current form; any new, different, or changed material facts or circumstances might render this letter void. Moreover, this letter represents the position of the Division only and does not necessarily represent the views of the Commission or those of any other division or office of the Commission. Should you have any questions, please do not hesitate to contact Parisa Abadi, Attorney-Advisor, at (202) 418-6620.

Sincerely,

Ananda Radhakrishnan
Director

Attachment

Exhibit I: Form of Proposed BoE Acknowledgment Letter (Futures)

[Date]

The Governor and Company of the Bank of England
Threadneedle Street
London EC2R 8AH

1. We refer to the Segregated Account which ICE Clear Europe Ltd. (“we” or “our”) have opened with the Governor and Company of the Bank of England (“you” or “your”) entitled: “ICE Clear Europe Ltd Futures Customer Omnibus Cash Account, CFTC Regulation 1.20 Customer Segregated Account under Sections 4d(a) and 4d(b) of the Commodity Exchange Act, abbreviated as “ICEU CSEG US FUTURES CASH”, sort code: [], account number [] (the “Account”).
2. We have informed you that we have opened the above-referenced Account for the purpose of depositing, as applicable, money, securities and other property (collectively the “Funds”) of customers who trade commodities, options, swaps, and other products, as required by Commodity Futures Trading Commission (“CFTC”) Regulations, including Regulation 1.20, as amended.
3. You have confirmed that the Funds held by you, hereafter deposited in the Account or accruing to the credit of the Account, will be separately accounted for and segregated on your books from our own funds and from any other funds or accounts held by us (which we have informed you is required pursuant to the provisions of the Commodity Exchange Act, as amended (the “Act”), and Part 1 of the CFTC’s regulations, as amended). We have informed you that we will otherwise treat the Funds in accordance with the provisions of Section 4d of the Act and CFTC regulations thereunder.
4. You have also agreed to waive, in respect of the Account, your rights of set off by including in your mandate for the Account a provision which has the effect of providing that, notwithstanding any provision of the terms and conditions governing the Account (the “**Terms and Conditions**”), you waive, in respect of the Account, your rights of set off arising under the Terms and Conditions and general law.
5. You agree to reply as soon as reasonably practicable and directly to any request for confirmation of account balances or provision of any other information regarding or related to the Account from the director of the Division of Clearing and Risk of the CFTC or the director of the Division of Swap Dealer and Intermediary Oversight of the CFTC, or any successor divisions, or such directors’ designees, and this letter constitutes the authorization and direction of the undersigned on our behalf to release the requested information without further notice to or consent from us.
6. We have informed you that we will not hold you responsible for acting pursuant to any information request from the director of the Division of Clearing and Risk of the CFTC or the director of the Division of Swap Dealer and Intermediary Oversight of the CFTC, or any successor divisions, or such directors’ designees.

7. Except with respect to paragraph 5 above, this letter is not intended to amend the mandate or the Terms and Conditions for the Account. For the avoidance of doubt, you provide no opinion on or agreement with information we have provided to you in this letter, including with respect to matters of U.S. law.

ICE Clear Europe Ltd

By: _____
Print Name:
Title:

ACKNOWLEDGED:

The Governor and Company of the Bank of England

By: _____
Print Name: _____
Title: _____
Contact Information: [Insert phone number and email address]
DATE: _____