

## CDS Clearing Overview

### Offered by IntercontinentalExchange

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IntercontinentalExchange (ICE) operates the first active clearing house for OTC credit default swap (CDS) products. During the first month of operation, ICE Trust U.S. LLC (ICE Trust), a subsidiary of ICE, accepted CDS trades for clearing with a total notional value in excess of \$70 billion USD. After netting, the resulting open interest on those trades was approximately \$14 billion USD as of April 13, 2009.

ICE Trust provides clearing for the most liquid North American CDX indices. There are 10 initial clearing members, comprising some of the largest bank participants in the CDS market. Over the coming weeks and months, ICE Trust will expand the scope of its offering to include additional members and additional CDS products.

ICE Clear Europe, a clearing house recognized by the U.K.'s Financial Services Authority (FSA) and a wholly-owned subsidiary of ICE, is preparing to launch clearing for European iTraxx products by mid-year 2009, pending regulatory approval. ICE Clear Europe will leverage the technology and business processes currently employed by ICE Trust. Together, ICE Trust and ICE Clear Europe will provide a compatible, robust, global CDS clearing solution that is customized to meet the specific business and regulatory requirements of the North American and European markets.

ICE's global solution for CDS clearing has been developed in conjunction with market participants, based on the following principles:

- It operates in conjunction with the existing, proven business processes and service providers currently in place within the CDS markets;
- It has an open membership model;
- It has an open execution model;
- It incorporates a regulatory oversight regime;
- It is capable of providing clearing and risk management services for the global suite of CDS products; and
- It conforms to the protocols and standards developed by the International Swaps and Derivatives Association (ISDA) in conjunction with its membership and the Operations Management Group (OMG).

ICE's CDS clearing solution has been rigorously tested, independently audited, and reviewed by a variety of regulatory agencies involved with the financial markets. The rapid adoption of the ICE Trust clearing service by leading market participants is an indication of the value ICE is providing to the CDS marketplace.

This document provides an overview of the two elements of ICE's global CDS clearing solution. The document will cover both the ICE Trust (US) and ICE Clear Europe (European) solutions. More focus will be placed on the ICE Trust solution, as that solution is already operating, but differences between the two clearing houses will be noted where possible. Given the planned compatibility between the two solutions, this will provide a good overview of ICE's global approach to CDS clearing.

## 1. Overview: Service Description

ICE will provide clearing for CDS products through two subsidiaries, ICE Trust and ICE Clear Europe. ICE Trust is already providing clearing for North American CDX products. ICE Clear Europe will provide clearing for European iTraxx products, and is expected to launch mid-year 2009, pending regulatory approval.

ICE Trust is currently acting as the central counterparty to North American CDS trades submitted for clearing. The trades are novated and netted, reducing the overall amount of trades outstanding, which reduces both market risk and credit risk. ICE Trust's trade submission process is designed to ensure that it maintains a matched book of offsetting CDS contracts, making ICE Trust market-risk neutral.

Under ICE Trust's clearing rules, a bilateral CDS contract between clearing members that is submitted to ICE Trust for clearing will be "novated". As part of this process, the submitted contract is replaced by two superseding CDS contracts between each of the original parties to the submitted transaction and ICE US Trust. Under these new contracts, ICE Trust will act as "protection buyer" to the original "protection seller" and as "protection seller" to the original "protection buyer".

ICE Trust will collect an initial margin deposit and perform a daily "mark-to-market" to ensure that each participant's positions are properly valued and collateralized, further reducing credit risk. In the event of a participant's default, ICE Trust will stand between the defaulting participant and the non-defaulting participants, and ICE Trust's rules provide for an orderly and systematic approach for unwinding the defaulting participant's positions.

ICE Trust has established a guaranty fund to provide protection covering losses that may occur when unwinding a defaulting participant's positions. All participants are required to make ongoing contributions to the guaranty fund in proportion to their share of the overall market risk. In the event of a default, ICE Trust will use the defaulting participant's margin collateral and guaranty fund contributions to cover the loss. In the event that the loss is greater than the amount on deposit, the remaining participants agree to share the losses of the defaulting participant by using the guaranty fund to cover the defaulting participant's losses. Because the losses are spread across ICE Trust and the non-defaulting participants, rather than being concentrated on a smaller number of parties, the risk of additional defaults is decreased.

The ICE Clear Europe solution will be appropriately modified to meet the specific business, legal and regulatory requirements of the European market. The solution will be segregated from ICE Clear Europe's existing energy clearing operations and include, for example, separate membership requirements and the establishment of a distinct guaranty fund for the CDS business. Where appropriate, ICE Clear Europe will leverage the business processes and technology developed for ICE Trust. Operating responsibility will reside with ICE Clear Europe.

## **2. Legal structure of the central counterparty (CCP), and ownership structure by the service provider or in partnership with stakeholders**

ICE Trust and ICE Clear Europe are separate legal entities and are both subsidiaries of ICE. Each will offer a clearing solution tailored to their specific markets, products and regulatory requirements. In order to maintain consistency, provide operating efficiencies and improve speed to market, the clearinghouses will, where appropriate, employ the same basic technology, operating procedures and risk management framework.

### **2.1. ICE Trust**

ICE Trust is organized under the laws of the State of New York as a limited liability trust company and is established to serve as a central clearinghouse for credit default swaps. ICE Trust is owned by IntercontinentalExchange, Inc. On March 6, 2009, ICE acquired The Clearing Corporation (TCC), whose shareholders included leading CDS dealers (Bank of America, Barclays, Citigroup, Credit Suisse, Deutsche Bank, Goldman Sachs, JP Morgan, Merrill Lynch, Morgan Stanley and UBS), leading CDS brokers and service providers (Creditex, GFI, ICAP and Markit), and Eurex. These former shareholders will participate in a portion of the profits from ICE Trust and TCC, but will not have any associated voting rights.

### **2.2. ICE Clear Europe**

ICE Clear Europe is based in London and incorporated as a private limited company in the U.K. It is a wholly-owned subsidiary of IntercontinentalExchange, Inc.

## **3. Governance structure, Board members, CEO, shareholdings**

### **3.1. ICE Trust**

The Board of ICE Trust consists of eleven members, the majority of whom are independent. This includes seven members appointed by ICE, a majority of whom are independent, and four members nominated by participants in the clearing house, two of whom are independent in accordance with requirements of the New York Stock Exchange listing standards, the Exchange Act, and ICE's Board of Director Governance Principle.

The ICE Trust management team reports to the ICE Trust Board. Dirk Pruis is the President of ICE Trust.

### **3.2. ICE Clear Europe**

ICE Clear Europe has a seven member Board of Directors, of which the majority are independent. The Board of Directors of ICE Clear Europe meets FSA recognition requirements. It is proposed that two additional Non-Executive Directors with CDS expertise will be appointed to the ICE Clear Europe board. A separate CDS Risk Committee will be established for ICE Clear Europe.

Paul Swann is the President and Chief Operating Officer of ICE Clear Europe.

**4. Product scope, which OTC products are (will be) supported, how close are they to pure OTC or exchange like OTC products?**

ICE has developed a comprehensive clearing and risk management solution for CDS indexes, single names and tranches. The ICE CDS clearing solution can accommodate the majority of products that are stored in the Depository Trust & Clearing Corporation (DTCC) Trade Information Warehouse. Cleared trades are stored in the DTCC warehouse as OTC trades. The exact products to be cleared will be determined in conjunction with market participants based on their demand to have specific products cleared.

ICE Trust is currently clearing North American CDS index products. The indices eligible for clearing are the CDX Investment Grade 5 Year and 10 Year (CDX.NA.IG), the CDX High Yield 5 Year (CDX.NA.HY), and the CDX High Volatility 5 Year (CDX.NA.IG.HVOL). ICE Trust is clearing Series 10 and 11 of those indices, and will soon begin clearing Series 12 of those indices. Additional back-dated series, additional indices and additional tenors may be added based on market demand. New series of the cleared indices will be added as those series are introduced. North American single name CDS products and North American CDS tranches will be added in the coming months, pending regulatory approval.

ICE Clear Europe will launch its offering with the iTraxx Europe 5 Year and 10 Year, the iTraxx Europe HiVol 5 Year and the iTraxx Europe Crossover 5 Year. Current plans are to begin clearing Series 9, 10 and 11 of these indices, with introduction of these products on a rolling basis following launch. Additional series, tenors and indices can be added based on market demand. New series of the cleared indices will be added as those series are introduced. European single name CDS products and European CDS tranches will be added after launch, pending industry approval of product standardization and price information availability Risk Committee and regulatory approval.

***4.1. Details of each contract or products. Please identify any differences with existing OTC contracts supported by the DTCC Trade Information Warehouse***

The products cleared by ICE Trust and ICE Clear Europe are the same as the products supported by the DTCC Trade Information Warehouse. The ICE solution utilizes an ISDA Master Agreement and conforms to existing industry practices, including trade registry in the DTCC Warehouse and central settlement using Continuous Linked Settlement Bank (CLS). Events will be handled under the ISDA auction process, and settled through DTCC/CLS.

The initial step for ICE Trust and ICE Clear Europe is clearing the historical trades housed in the DTCC Trade Information Warehouse, with an initial focus on the most liquid contracts with the highest number of outstanding trades. New index series will be added as they are released. Older series will be added based on the amount of open positions and the utility value to the market participants.

## 5. Membership requirements and membership structure (for direct and indirect members)

ICE Trust is an independent, neutral clearing house open to all qualified market participants. In keeping with regulatory guidance provided by the Bank for International Settlements (BIS), the Federal Reserve Bank of New York and others, ICE Trust membership requirements have been established to assure that clearing members have adequate resources, controls and domain expertise to be a counterparty in the central clearing function. Accordingly, clearing members are required to demonstrate sufficient operational capabilities, financial resources, risk management experience and regulatory oversight to qualify to participate in ICE Trust.

In order to qualify as a participant of ICE Trust, an applicant will be required to satisfy participant criteria, including the following requirements:

- Applicant is regulated by a competent authority for capital adequacy, or an affiliate of applicant is so regulated, and applicant is subject to consolidated holding company group supervision;
- Applicant has \$5 billion of Tangible Net Worth (equivalent to Federal Reserve Tier 1 capital) where the requirement may be met by a parent guarantor;
- Applicant has a credit rating of at least “A” where the requirement may be met by a parent guarantor. In the absence of a credit rating, applicant may demonstrate that it otherwise satisfies stringent credit criteria;
- Applicant demonstrates operational competence and risk management competence;
- Applicant is a member of industry organizations (such as ISDA, DTCC Deriv/SERV); and
- Applicant is organized in a jurisdiction whose insolvency laws are acceptable to ICE Trust.

Any firm, including buy-side firms, meeting ICE Trust’s membership qualifications will be eligible for member status, including applicants that are not organized or domiciled in the United States. For more information regarding membership requirements and the membership application process, please refer to the ICE Trust rules, which are posted on the ICE Trust website, and can be accessed through this link: [https://www.theice.com/publicdocs/clear\\_us/ICE\\_Trust\\_Rules.pdf](https://www.theice.com/publicdocs/clear_us/ICE_Trust_Rules.pdf)

Market participants who do not meet the ICE Trust membership criteria or do not wish to be clearing members will need to establish a relationship with a clearing member. ICE Trust is working actively with dealers and buy-side firms to develop the appropriate business processes, legal relationships and rules by which non-members can have enhanced segregation of margin and portability of positions. We expect this enhanced solution to be available to customers in the coming months. In the interim, ICE Trust has taken steps to mitigate risk for all market participants by establishing Rule 405(b) requiring clearing members to offer non-clearing – participants the option to have their collateral held in accounts that are segregated from the accounts of the clearing members.

ICE Clear Europe’s current membership structure will be enhanced to provide for the addition of CDS products. Existing clearing members will be required to fulfill additional criteria specific to CDS clearing, including minimum capital requirements, operational criteria and contribution to a separate guaranty fund. The membership documentation is available to qualified firms.

### ***5.1. How a firm with multiple internal divisions is supported***

The ICE solution allows a firm with multiple divisions to separate or commingle the CDS trades of each of its divisions. Firms can choose to have the CDS positions of all internal divisions netted against each other, keep all divisions separate, or keep some divisions separate and group others for netting. Similarly, the clearing house also has the flexibility to net trades within a division or hold them as offsetting open positions. Regardless of the type of division grouping and position netting a firm chooses to adopt, the margin calculation will be based on the net CDS exposure across the entire firm, as long as the entire firm is represented by a single clearing member.

### ***5.2. How a firm with multiple legal entities is supported***

Clearing memberships are specific to legal entities. Each clearing member is risk managed, separately margined, and required to meet its individual guaranty fund requirements, regardless of whether it has a common parent with another clearing member.

A firm with multiple legal entities has the option to clear its CDS positions from multiple entities through a single legal entity using the same position management options as described above. In this case, the clearing house will recognize only the legal entity that is the clearing member. If another legal entity within the firm wishes to establish its own distinct legal relationship with the clearing house, that entity needs to obtain its own clearing membership. If a firm has multiple legal entities acting as clearing members, the positions of those clearing members cannot be netted against each other.

Membership in ICE Trust and ICE Clear Europe are not reciprocal. A firm wishing to clear North American CDS products must have a membership with ICE Trust, and a firm wishing to clear European CDS products must have a membership with ICE Clear Europe. Similarly, financial positions against one clearing house cannot be used to offset financial positions against the other clearing house.

Current and proposed clearing members are domiciled in the US, England, Germany, France, Scotland and Switzerland. The only restriction on accepting members from additional jurisdictions is based on the enforceability of the ICE Trust/ICE Clear Europe Rules (especially with regard to the termination and netting provisions).

## **6. Margin methodology**

ICE Trust has developed a proprietary risk management framework to model the risk in the CDS market. The portfolio margining approach is based upon advanced statistical techniques that model the dynamics of the asymmetric distribution of credit spreads and capture co-movements among CDS products. This framework is used to calculate the margins and determine the guaranty fund contributions for each clearing member.

Subject to regulatory and Risk Committee approval, ICE Clear Europe will adopt broadly the same

risk management framework as that developed by ICE Trust. This risk management framework will be subject to minor amendments because of the specific nature of the iTraxx products and the range of cash and collateral which can be deposited by clearing members to meet margin and guaranty fund requirements. The responsibility for risk management of CDS products cleared by ICE Clear Europe will lie with ICE Clear Europe's Head of Risk.

Clearing members must post initial margin based on their net positions with the clearinghouse and are then required to post mark-to-market margin in accordance with End-of-Day (EOD) mark-to-market processes run by the clearinghouse. Members are also required to contribute to the guaranty fund in proportion to the risk of their cleared positions. In the event of a default, the risk management framework has multiple levels of protection, including the margin, guaranty fund and assessment rights.

### ***6.1. Variation margin or equivalent including pricing method and data sources***

Variation, or mark-to-market, margin is calculated on a daily basis based on the changing market value of held positions. ICE Trust calculates the value of a member's positions by marking to market all positions held by the clearing member using the clearing house-derived EOD settlement prices. Clearing members are required to post additional mark-to-market margin when the prior day's margin balance is insufficient to meet the current day's margin obligation. In addition:

- Mark-to-market margin is paid in cash to ICE Trust or credited to the clearing member's account daily;
- A clearing member can withdraw excess cash that has been credited to the member's account; and
- Interest is paid by receiver and earned by payer of mark-to-market margin, similar to OTC market convention.

Mark-to-market valuations are based on the official EOD settlement price, which is determined using a proprietary process established by ICE Trust. Initial daily settlement prices are calculated from the daily prices submitted by each member firm with a cleared interest.. These prices are used to determine a best bid-offer price for each cleared product. The official settlement prices are established by ICE Trust after validation with appropriate pricing engines, and with any necessary adjustments based on market conditions.

### ***6.2. Initial margin or equivalent, and calculation methodology***

The initial margin accounts for the movement of credit spreads as modeled by the risk management system. The margin requirement is obtained by estimating the portfolio profit/loss, using an approach that considers hedging and offset benefits by modeling the co-movements among CDS products. In general, ICE Trust's initial margin requirements are:

- Clearing members will maintain collateral on deposit sufficient to cover a five day risk horizon;
- Acceptable collateral will initially include cash and G7 government debt;

- End-of-Day margin deficit will be covered by cash the following morning (subsequent substitution of collateral for cash is allowed); and
- Cash posted as collateral will be paid interest

### ***6.3. Default or guaranty fund, structure, size and calculation method***

The ICE Trust guaranty fund is dedicated exclusively to protecting the ICE Trust members clearing CDS contracts through ICE Trust. The guaranty fund's structure is based on potential losses that could occur under extreme but plausible market conditions.

Initially, each clearing member is required to make a minimum contribution to the guaranty fund. Members are subsequently required to maintain appropriate guaranty fund deposits based on their risk profile, which is reassessed on an ongoing basis. ICE is also a contributor to the guaranty fund.

ICE Trust manages the overall size of the guaranty fund to cover the projected losses of multiple large counterparties in deteriorating market conditions. ICE Trust also has certain assessment rights against remaining, non-defaulting clearing members.

ICE Trust has established default resources according to its operating procedures, including the collection of risk-based margin and the creation of a guaranty fund. These procedures have been evaluated by the relevant regulatory agencies prior to issuing their regulatory approvals. Default resources at ICE Trust will scale commensurate with the notional value of trades processed by the clearing house and the resulting risk profile of these positions. In the first month of operations, trade backloading activity has been limited at the requests of global regulators. As more positions are novated to ICE Trust in the coming weeks, the clearing house expects its default resources to increase significantly as the backloading process accelerates substantially and more new trades are submitted for clearing.

### ***6.4. Stress testing approach***

Stress testing is performed on a daily basis. The ICE Trust stress testing practices focus on ensuring the adequacy of systemic risk protection. These practices are integrated into ICE Trust's risk management procedures and governance structure to:

- Ensure that appropriate levels of risk collateralization and mutualization are established and efficiently maintained;
- Provide a mechanism for ICE Trust management to test the level of protection provided under plausible default scenarios;
- Alert management to potential adverse, unexpected outcomes related to participant's cleared portfolios; and
- Complement and enhance the risk management framework to account for low-probability market scenarios that may not be included in the margin and guaranty fund risk approach.

### ***6.5. Cross margining capability with other products***

In order for cross margining between products to be effective, those products should exhibit predictable and correlated behavior under a given set of market conditions. The initial assessment of ICE Trust is that there does not appear to be a strong correlation between CDS and most commodities, as evidenced by the fact that most clearing solutions, as well as all the market participants that ICE has consulted, are employing different risk management systems and business processes to manage CDS products.

ICE Clear Europe does not intend to offer cross margining between CDS and other ICE Clear Europe products. ICE Trust clears CDS products only.

### ***6.6. Cross margining capability with other services or jurisdictions***

ICE Trust and ICE Clear Europe are well-positioned to offer cross margining at some point in the future, given their shared approach to risk management, the compatibility of their clearing solutions and their relationship as affiliates. However, additional work is required to establish the required business processes and a legal framework that will meet the needs of the respective clearing houses, market participants and regulators.

### ***6.7. Any details you would like to include on back testing and other risk management techniques***

Back testing is performed daily to evaluate the adequacy of the risk methodology by comparing the amount of available default resources to the actual profit/loss of each clearing member. Exceptions are identified and used to calibrate the risk model.

The risk management system monitors clearing members on a daily and intra-day basis. Several factors are considered in evaluating a clearing member's risk profile, such as concentration of positions and increased market volatility. Limits and controls, in the form of margin increases and watch lists, are imposed to manage risk.

### ***6.8. Methodology behind any Intraday margin calls and related procedures***

Intraday margin calls can be made as deemed appropriate by the Chief Risk Officer based on feedback from risk monitoring systems, current market conditions and/or clearing member specific conditions such as a credit rating downgrade. Margin calls must be satisfied immediately.

## **7. Connectivity to other services, including DTCC / Markit / T:Zero or Trading platforms, and intended automation plans such as spreadsheets or direct computer links**

ICE Trust has structured its clearinghouse to leverage the existing business processes currently in use by the industry. This includes the Trade Information Warehouse provided by DTCC's Deriv/SERV, the price distribution network operated by Markit, the net settlement system operated by DTCC and CLS and the buy side connectivity available through ICE Trust's affiliate T-Zero.

ICE Trust has integrated its clearing house operations with the asset servicing capabilities of DTCC's Deriv/SERV. Major market participants are already using DTCC's Deriv/SERV matching and confirmation service to document their CDS transactions. Confirmed transactions are forwarded to the Deriv/SERV Trade Information Warehouse, which serves as the primary registry for confirmed transactions. When trades are submitted for clearing, they are novated and netted, resulting in positions between the clearinghouse and the clearing members. These new positions are also stored in the Trade Information Warehouse, and the old positions are torn up.

ICE Trust also leverages the central settlement facility currently operated by Deriv/SERV and CLS Bank to administer the calculation and transfer of periodic payments between protection buyers and protection sellers. The payments include coupon payments and final settlements. ICE Trust adhered to the "big bang" protocol, and has adopted the hardwiring process implemented by ISDA .

Markit is a service provider to ICE Trust. It is executing the settlement process policies and procedures developed by ICE Trust relating to the end of day settlement pricing process. This includes collection of the pricing information from the clearing participants, initial calculation of the daily mark-to-market price using the settlement pricing algorithm developed by ICE Trust, and distribution of settlement prices to clearing participants after validation by ICE Trust. Markit will also be responsible for broad distribution of official mark-to-market settlement prices to the marketplace.

T-Zero is expected to play a role in the expansion of the clearing solution by leveraging its proven back office processes and existing connectivity to all of the major CDS dealers, over 350 buy side firms, and the DTCC Trade Information Warehouse.

ICE is also in discussions with other brokers and electronic execution platforms. Trades executed through any of these venues will all be eligible for clearing. ICE will continue to work with individual entities to enable further automation as requested by market participants.

## **8. Interoperability – with which entity (ies) and if any, please define dimensions**

ICE Trust is providing open access to its clearing model and will accept appropriately matched trades from any execution venue or trade matching/affirmation platform. The ICE Trust solution is completely vendor neutral. Any trade stored in the DTCC Trade Information Warehouse, regardless of execution venue, is eligible for clearing, provided the transaction involves a product that is available for clearing and was executed between two eligible clearing members. Middle and back office service providers can consult with clearing members to determine what additional services may be required, and how they should be integrated.

At launch, there will be no interoperability between ICE Trust and ICE Clear Europe.

## **9. Regulatory background**

ICE Trust is authorized as a New York State limited purpose trust company by the New York State



Banking Department. As such, ICE Trust has received regulatory approval from the Board of Governors of the Federal Reserve System to become a member of the Federal Reserve System and to serve as a clearinghouse and central counterparty for CDS transactions.

ICE Trust is also operating pursuant to a Securities and Exchange Commission (SEC) exemption. The temporary exemption order provides (1) ICE Trust an exemption from registration as a clearing agency and as an exchange with the SEC, and (2) ICE Trust and its participants an exemption from any requirement that they comply with certain provisions of the Exchange Act governing securities transactions, to the extent such provisions would otherwise be applicable to ICE Trust and its Participants, and (3) any inter-dealer broker an exemption from any requirement that it comply with provisions of the Exchange Act governing securities transactions, to the extent such provisions would otherwise be applicable to such inter-dealer broker, in connection with the effectuation by such inter-dealer broker of CDSs submitted to ICE Trust for clearance and settlement.

ICE Trust has also obtained an exemption from the Department of the Treasury (the Department) for ICE Trust, its participants and the inter-dealer brokers from the provisions of Sections 15C(a), (b) and (d) of the Exchange Act (other than subsection (d)(3)) and the rules and regulations of the Department thereunder, applicable to government securities brokers and government securities dealers, to the extent such requirements, rules and regulations would otherwise be applicable to their activities in connection with the offer, execution, termination, clearance, settlement, performance and related activities involving CDS entered into by such Participants with other Participants and submitted to ICE Trust for clearance and settlement.

In May 2008, ICE Clear Europe received recognition from the UK FSA as a UK Recognized Clearinghouse, and began operations in November 2008. In December 2008, ICE Clear Europe received settlement finality designation (SFD) by the UK FSA under the Financial Markets and Insolvency (Settlement Finality) Regulations 1999.

### ***9.1. Which regulatory body***

ICE Trust and ICE Clear Europe will each comply with the regulatory requirements of the respective markets in which they operate.

As a New York State limited purpose trust company and Federal Reserve System member bank, ICE Trust is subject to direct supervision by the Federal Reserve Bank of New York as well as by the New York State Banking Department.

In November 2008, the Federal Reserve, the SEC and the Commodity Futures Trading Commission (CFTC) signed a memorandum of understanding whereby they agreed to share information regarding the CDS market. Pursuant to terms of that MOU, should the SEC or the CFTC request information from the Federal Reserve regarding ICE Trust, we will comply with those requests as recommended by our primary regulator, the Federal Reserve.

ICE Clear Europe is regulated by the FSA and is in discussions with the FSA in relation to the extension of its clearing services to cover CDS products. ICE Clear Europe is actively engaged in

the on-going dialogue between other European institutions and regulatory authorities.

### **9.2. Treatment of trades for capital purposes**

Trades will be recorded as cleared OTC trades and held against a central counterparty clearinghouse. Multi-lateral netting should significantly reduce the total amount of open positions recorded on the balance sheet. Clearing members will be responsible for determining their appropriate capital treatment.

### **9.3. Segregation into a US / European service, details of any differences from a legal, governance, regulatory or default fund point of view**

Strategically, ICE Trust and ICE Clear Europe are coordinating to provide a global CDS clearing solution. Where practical, they will employ common business practices and technology solutions, adapted appropriately to meet their respective market and regulatory requirements.

Legally, ICE Trust and ICE Clear Europe are separate entities. They clear different CDS products, maintain separate margin accounts, operate their own guaranty funds and are subject to different regulatory oversight.

Clearing memberships are specific to each of these legal entities, and are not transferable between entities. A firm that is a clearing member of both clearinghouses cannot offset its obligations (e.g., guaranty fund contributions, margin deposits) between the clearing houses.

Details regarding governance and regulatory status are included in previous responses.

## **10. Buy-side involvement**

The ICE solution is open to the buy-side, both as clearing members and as market participants who are not clearing members. ICE is working with current clearing members and buy-side representatives to provide a solution that offers enhanced segregation of margin and portability of positions. For further details on membership, please refer to Section 5.

## **11. Trade servicing, such as post-trade events support (partials, amendments, novations)**

The use of partials to adjust a bi-lateral trade is no longer necessary once that trade has been submitted for clearing. If a clearing member wants to increase or decrease trade exposure, the member will simply execute an appropriate trade with any other clearing member, submit it for clearing, and it will be applied against the net position. The use of partials to adjust trades that have not been submitted for clearing is unchanged.

Amendments to bi-lateral contracts will be handled by counterparts to the transactions in advance of clearing. Industry-wide amendments to cleared contracts will be handled through the DTCC Trade Information Warehouse and applied to the positions of all clearing members. Bilateral amendments of cleared positions will not be possible: netting requires the clearinghouse to

maintain a balanced book of positions with common attributes.

Novations will be addressed through netting and portability. Novations between clearing members will no longer be required, as multi-lateral trade netting eliminates the need for that function. Novations between clearing members and non-clearing members will be addressed through the non-member clearing solution currently being developed in consultation with clearing members and representatives from buy side firms.

## **12. Trade netting approach and effect on novations**

The clearinghouse will use multi-lateral netting to reduce a clearing member's trade exposure to a single net position facing the clearing house for each cleared product. The ICE solution provides the flexibility for members to group trades into homogenous subsets for netting purposes, so that different subset of trades within the member firm (e.g., trading desks, divisions, funds) can be netted separately. All trades, regardless of where they originate within a clearing member firm, are novated between the clearing house and the legal entity that is the clearing member.

## **13. Clearing & settlement cycle timing and supported currencies, settlement infrastructure and usage of CLS if any**

During the backloading process, ICE is operating a weekly clearing cycle that allows firms to submit large groups of positions for clearing each week. This approach facilitates the reduction of open positions most effectively. Following the backloading process and testing of newly released functionality with DTCC, ICE will move to daily clearing cycles.

Margin collections are performed daily using a direct settlement model. Coupons and final cash settlements are processed through the DTCC/CLS net settlement system currently in use by most major market participants. Any G7 currency can be accepted for initial margin. Mark-to-market margin must be posted in the currency of the underlying traded product. Coupons and final settlements occur in the currency of the underlying traded product.

## **14. Credit Events approach, including any information on cash or physical settlement, plus handling of a restructuring event**

Credit events will be handled according to the ISDA "hardwiring" protocol. Clearing members will participate in the ISDA auction settlements, with fallback to physical settlement.

Restructuring applies predominantly to European CDS products. The ISDA Credit Derivatives Determinations Committee first resolves that there has been a restructuring. If so, ICE Clear Europe will convert the cleared index positions to a new version of the index (without the restructured reference entity) and the restructured single name will be submitted to the members as a bilateral trade. Subsequent transactions in all prior versions of the trades submitted for clearing (post-restructuring declaration) will be similarly converted into a cleared position in the new index version and a bilateral trade between the members for the underlier affected by restructuring.

## 15. Corporate Actions such as mergers, book changes, member default process, back-loading

Corporate actions are handled through DTCC Deriv/SERV processing.

In the event of a clearing member default, ICE Trust will terminate and close out the positions of the defaulting member. The portfolio of the defaulting member will be hedged or liquidated as appropriate. The margin collateral posted by the defaulting member will be used to offset any losses incurred. If the margin is insufficient to cover the defaulting member's obligations, ICE Trust will then use the defaulting member's guaranty fund contribution to offset any losses incurred.

Ultimately, if the defaulting member's margin collateral and guaranty fund contribution are insufficient to cover its obligations, the remaining losses will be mutualized. ICE Trust will be authorized to use, to the extent needed, the remaining guaranty fund contributions made by ICE and the non-defaulting members to meet any unsatisfied obligations of the defaulting clearing member.

Backloading will be possible at anytime, as the ICE solution does not require that trades be submitted for clearing immediately upon execution. Confirmed CDS transactions will continue to be forwarded by market participants to the Deriv/SERV Trade Information Warehouse, which serves as the primary registry for confirmed transactions, whether they are cleared or bilateral. Members can submit transactions for clearing from the DTCC Trade Information Warehouse to ICE Trust. Any transaction between clearing members submitted to the DTCC Trade Information Warehouse, regardless of execution venue or execution date, will have the option to be cleared through ICE Trust, provided the contracts are made available for clearing.

## 16. URL and other contact details for further information

Information regarding ICE Trust can be obtained from the ICE Trust website:

[https://www.theice.com/ice\\_trust.jhtml](https://www.theice.com/ice_trust.jhtml)

Questions regarding ICE Trust can be sent to [icetrust@theice.com](mailto:icetrust@theice.com)

Information regarding the ICE Clear Europe CDS solution will soon be available at the ICE Clear

Europe web site: [https://www.theice.com/clear\\_europe.jhtml](https://www.theice.com/clear_europe.jhtml)

Questions regarding ICE Clear Europe can be sent to [iceclearuropecds@theice.com](mailto:iceclearuropecds@theice.com)

## 17. Service Pricing & Economics (within the limits of your own commercial confidentiality)

ICE Trust has a variable fee schedule based upon notional values cleared. Specific fee information is available to qualified clearing applicants.

Fees for ICE Clear Europe have not yet been established.

End of Document