



Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

May 6, 2009

Interpretive Letter #1116
May 2009
12 CFR 3

Dear []:

This is in response to your memorandum dated November 21, 2008, on behalf of [*Bank1*, *Bank2*, *Bank 3*, *Bank4*, and *Bank5*] (the Banks). The memorandum requests a determination on the risk-based capital treatment for the Banks' exposures to ICE US Trust LLC, a New York State-chartered, limited-purpose trust company (ICE Trust), which is a member of the Federal Reserve System and subject to the regulatory and supervisory requirements of the Federal Reserve Board (FRB) and the New York State Banking Department. ICE Trust will serve as a central counterparty for purposes of clearing certain credit default swap (CDS) transactions between participants in ICE Trust.

Pursuant to 12 CFR §3.4(b), for the reasons set forth below, the Office of the Comptroller of the Currency (OCC) believes it is appropriate for a Bank to assign a risk weight of 20% to the exposures resulting from the Bank's membership in and transactions with ICE Trust.

Description of ICE Trust

ICE Trust is an uninsured trust company organized under New York State law. While ICE Trust will not accept deposits from the general public nor have federal deposit insurance, it has stipulated that it is subject to the supervisory, examination and enforcement authority of the FRB under the Federal Deposit Insurance Act as if ICE Trust were an insured depository institution.¹

ICE Trust provides CDS clearing services to its clearing participants (members) by novating and clearing trades executed by members. Members will present to ICE Trust for clearing bilateral contracts that will be replaced by two superseding CDS contracts between ICE Trust and each party to the bilateral transaction. Under the new contracts, ICE Trust will assume the counterparties' obligations under the original contracts and effectively become the central counterparty. The OCC confirmed that it is permissible for a national bank to participate as a

¹ Board of Governors of the Federal Reserve System Order Approving Application for Membership of ICE US Trust LLC effective March 4, 2009.

clearing member of ICE Trust provided the bank, prior to becoming a member, establishes a comprehensive risk management framework, and receives a written supervisory no-objection from its examiner-in-charge.²

To become a member of ICE Trust, an institution must meet certain financial, operational and legal criteria. A member must be licensed and regulated for capital adequacy by a competent authority such as the OCC, FRB and the U.K. Financial Services Authority. In addition, members provide initial and mark-to-market margin (margin) on contracts cleared with ICE Trust and contribute to ICE Trust's guaranty fund, which is available to cover any member's default. ICE Trust imposes a \$20 million minimum guaranty fund contribution,³ with the actual amount of the contribution determined based on the nature and scope of, and risk associated with, the CDS activities of each member. If a member's portfolio presents increased risk, ICE Trust may require the member to increase the amount of its guaranty fund contribution. In the event of a default of a member, the margin and guaranty fund contribution of that member will be used to pay the costs of closing out the defaulting member's position. However, if the defaulting member's margin and guaranty fund contribution are insufficient to cover such costs, the rules of ICE Trust describe the procedure for covering such costs from contributions from ICE Trust and the guaranty fund contributions of the non-defaulting members.

Risk-Based Capital Treatment

A Bank will have three types of exposures to ICE Trust resulting from its membership in ICE Trust and CDS transactions cleared with ICE Trust: (1) counterparty credit exposure arising from the cleared CDS contracts, which are over-the-counter (OTC) derivatives, (2) exposure from margin posted as collateral for those contracts, and (3) exposure from the bank's guaranty fund contribution. The OCC's general risk-based capital rules (12 CFR Part 3, Appendix A) require a national bank to assign a risk weight to on-balance-sheet and certain off-balance sheet exposures. Under those rules, the Banks' exposures to ICE Trust arising from the margin posted and the contribution to the guaranty fund would receive a risk weight of 100%. While ICE Trust is a member of the Federal Reserve System and subject to the regulatory and supervisory requirements of the FRB and the New York State Banking Department, it is not a depository institution as defined in 12 CFR Part 3, Appendix A, Section 1(c)(14). Accordingly, ICE Trust would not qualify for a 20% risk weight category as a depository institution. For the Banks' counterparty credit risk exposures arising from CDS contracts cleared through ICE Trust, the risk weight according to the general risk-based capital rules would be 50%, the maximum risk weight for such exposures according to 12 CFR Part 3, Appendix A, § 3(b)(7)(iii).

Under the OCC's reservation of authority in 12 CFR § 3.4(b), on a case-by-case basis, the OCC may look to the substance of a transaction and assign a risk weight to an asset that more appropriately reflects the risks of that transaction. The OCC believes that a risk weight of 20% more appropriately reflects the risks of the three types of bank exposures to ICE Trust described

² OCC Interpretative Letter No. 1113 (March 4, 2009) (IL 1113), *available at* www.occ.gov/interp/mar09/int1113.pdf.

³ The guaranty fund contribution may be in the form of cash, U.S. Treasury or agency securities or other approved G7 debt.

in the paragraph above than the approach of 12 CFR Part 3, Appendix A. The OCC has reached this conclusion based on the nature of the membership of ICE Trust and the regulated nature of ICE Trust. As summarized above and described in detail in IL 1113, in order to become a member of ICE Trust, an entity must meet financial, operational and legal criteria established by ICE Trust and be licensed and regulated for capital adequacy. ICE Trust is a member of the Federal Reserve System and subject to the regulatory and supervisory requirements of the FRB and the New York State Banking Department. ICE Trust has stipulated that it is subject to the supervisory, examination and enforcement authority of the FRB under the Federal Deposit Insurance Act as if ICE Trust were an insured depository institution. In addition, both the Securities and Exchange Commission and the Commodity Futures Trading Commission may request the review of ICE Trust transaction data from its primary regulator, the FRB.

Conclusion

Accordingly, we conclude that, effective upon its receipt of the supervisory non-objection required by IL 1113, a Bank may assign a 20% risk weight to its: (1) counterparty credit exposure to ICE Trust arising from the cleared CDS contracts, (2) exposure from margin posted as collateral for those contracts, and (3) exposure from its guaranty fund contribution.

This approval and the activities and communications by OCC employees in connection with the Banks' request do not constitute a contract, express or implied, or any other obligation binding upon the OCC, and do not affect the ability of the OCC to exercise its supervisory, regulatory and examination authorities under applicable law and regulations. Consequently, if in the future a change to the OCC's regulations results in a different approach to the calculation of risk-based capital charges for the exposures described in this letter, the Banks would be subject to those revised regulations, notwithstanding this letter.

The OCC's determination is based on the description of ICE Trust and the Banks' exposures to ICE Trust contained in your memorandum and in IL No.1113. Any material change in those facts and circumstances, or a failure by any of the Banks to satisfy the requirements of IL No. 1113, may result in a different conclusion or in a revocation of the regulatory capital treatment described above.

If you have further questions, please do not hesitate to contact Margot Schwadron in the Capital Policy Division on 202-874-6022.

Sincerely,

signed

Amrit Sekhon
Director
Capital Policy