



SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-84312; File No. SR-ICC-2018-009]

Self-Regulatory Organizations; ICE Clear Credit LLC; Order Approving Proposed Rule Change Relating to ICC's Treasury Operations Policies and Procedures

September 28, 2018

I. Introduction

On July 31, 2018, ICE Clear Credit LLC ("ICC") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² a proposed rule change (SR-ICC-2018-009) to revise the ICC Treasury Operations Policies and Procedures ("Treasury Policy").³ The proposed rule change was published in the Federal Register on August 16, 2018.⁴ The Commission did not receive comments on the proposed rule change. For the reasons discussed below, the Commission is approving the proposed rule change.

II. Description of the Proposed Rule Change

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Capitalized terms used herein but not otherwise defined have the meaning set forth in the ICC Rules or the Treasury Policy. Available at https://www.theice.com/publicdocs/clear_credit/ICE_Clear_Credit_Rules.pdf.

⁴ Securities Exchange Act Release No. 34-83819 (August 10, 2018), 83 FR 40813 (August 16, 2018) (SR-ICC-2018-009) ("Notice").

The proposed rule change would amend the Treasury Policy. In accordance with CFTC Regulation 1.25,⁵ the Treasury Policy currently prohibits ICC from investing both Euro-denominated and U.S. Dollar-denominated cash posted by Clearing Participants (“CPs”) for their margin requirements related to client positions (“Customer Origin Cash”) in foreign sovereign debt. ICC may hold U.S. Dollar-denominated cash in its account at the Federal Reserve Bank of Chicago. ICC’s default position is to hold U.S. Dollar-denominated cash, including both Customer Origin Cash and cash posted by CPs for their Guaranty Fund (“GF”) and margin requirements related to their own positions (“House Origin Cash”) in its Federal Reserve account. ICC cannot hold Euro-denominated Cash in its Federal Reserve account, however, and therefore holds such cash elsewhere. Specifically, Euro-denominated House Cash is either invested in certain sovereign debt (currently, German, French, Dutch, or Finnish debt) pursuant to ICC’s current Euro Investment Guidelines or at commercial banks in unsecured demand deposit accounts subject to the credit risk of the commercial bank. Until recently, CFTC Regulation 1.25 prohibited Euro-denominated Customer Cash from being invested in foreign sovereign debt, and so was held exclusively at commercial banks in unsecured demand deposit accounts. However, the Commodities Futures Trading Commission (“CFTC”) recently issued an exemptive order⁶ (the “CFTC Order”) permitting ICC to

⁵ 17 CFR 1.25.

⁶ Order Granting Exemption From Certain Provisions of the Commodity Exchange Act Regarding Investment of Customer Funds and From Certain Related Commission Regulations, 83 FR 35241 (July 25, 2018) (“CFTC Order”).

invest, subject to certain conditions, Euro-denominated Customer Origin Cash in French and German sovereign debt.⁷

Accordingly, the proposed rule change would update the Treasury Policy in light of the CFTC Order. Specifically, as described in more detail below, the proposed rule change would, among other things, amend the Treasury Policy to permit ICC to invest Euro-denominated Customer Cash in certain foreign sovereign debt.

A. Changes Relating to Customer Origin Cash and House Origin Cash

To implement the change described above in response to the CFTC Order, the proposed rule change would (1) allow ICC to invest Customer Origin Cash in accordance with the Treasury Policy's guidelines for investing House Origin Cash; (2) revise those investment guidelines to provide for the investment of Euro-denominated Customer Origin Cash in French and German sovereign debt in accordance with the requirements of CFTC Regulation 1.25⁸ and the CFTC Order; (3) separate the 'ICC Investment of Guaranty Fund and Margin Cash' subsection into USD and Euro headings and make additional edits under those headings; and (4) amend provisions regarding ICC's use of its Federal Reserve Account.

First, the proposed rule change would allow ICC to invest Customer Origin Cash in the same manner as House Origin Cash in accordance with the Treasury Policy's investment guidelines (proposed changes to treatment of House Origin Cash are described below) by adding a new 'Investment of Client Margin Cash' subsection within the 'Treasury Management for Client Business' section, which would state that ICC will

⁷ Notice, 83 FR at 40814.

⁸ 17 CFR 1.25.

invest Customer Origin Cash in accordance with Sections III.B.2 and III.B.3 of the Treasury Policy, which describe how ICC invests House Origin Cash.⁹ The proposed rule change would specify that any such investment will be executed in compliance with CFTC Regulation 1.25¹⁰ and any applicable exemptive orders, including, without limitation, the conditions in CFTC Regulation 1.25¹¹ related to the investment of Customer Origin Cash in non-U.S. sovereign debt.¹²

Second, the proposed rule change would revise the Treasury Policy's Euro investment guidelines to allow ICC, or an Investment Manager acting on its behalf, to invest Euro-denominated Customer Origin Cash.¹³ Currently, the Euro investment guidelines only provide for the investment of Euro-denominated House Origin Cash. In light of the fact that the CFTC Order would permit ICC to now invest Euro-denominated Customer Origin Cash in French and German sovereign debt, the proposed rule change would apply the Euro investment guidelines to Customer Origin Cash to allow for such investment.¹⁴

In accordance with the CFTC Order,¹⁵ the proposed rule change would amend the Euro investment guidelines to limit permissible investment, directly and through reverse

⁹ Notice, 83 FR at 40814.

¹⁰ 17 CFR 1.25.

¹¹ Id.

¹² Notice, 83 FR at 40814.

¹³ Id.

¹⁴ CFTC Order, 83 FR at 35244-35245.

¹⁵ Id.

repurchase agreements (“reverse repo”), to French and German sovereign debt.¹⁶ If 100% of the allocated cash cannot be placed in overnight reverse repo, the investment guidelines would provide for backup investments in term reverse repo¹⁷ and then direct investment in the sovereign debt.¹⁸ The proposed rule change would apply these changes to both Euro-denominated Customer Origin Cash and Euro-denominated House Origin Cash. Previously the Euro investment guidelines permitted investment of Euro-denominated House Origin Cash in Dutch and Finnish sovereign debt, in addition to French and German. To be consistent with ICC’s treatment of Customer Origin Cash, the proposed rule change would also limit investment of House Origin Cash to French and German sovereign debt.

With respect to Euro-denominated Customer Origin Cash only, however, the proposed rule change would require that investments comply with any applicable conditions or restrictions set forth in CFTC Regulation 1.25¹⁹ including any applicable exemptive orders.²⁰ The proposed rule change would also provide that should conditions change so that the French or German sovereign debt no longer meets the conditions or restrictions of CFTC Regulation 1.25,²¹ the outside investment manager shall discontinue

¹⁶ Notice, 83 FR at 40814.

¹⁷ With respect to Customer Origin Cash, an investment in term reverse repo would only be permissible if the Client has the right of optional early termination upon demand.

¹⁸ Notice, 83 FR at 40814.

¹⁹ 17 CFR 1.25.

²⁰ Notice, 83 FR at 40814.

²¹ 17 CFR 1.25.

making any additional investments in such sovereign debt issuers.²² These limitations would be necessary to comply with the terms of the CFTC Order.²³ Because the CFTC Order only applies to Customer Origin Cash, it is not necessary to apply these changes to House Origin Cash.²⁴

Third, in response to the exemptive relief permitting ICC to invest Euro-denominated customer funds in French and German sovereign debt, the proposed rule change would separate the ‘ICC Investment of Guaranty Fund and Margin Cash’ subsection into USD and Euro headings. The proposed rule change would add a proposed ‘Euro’ heading, which would permit ICC’s Treasury Department to directly invest Euro-denominated Customer Origin Cash and House Origin Cash. Under the proposed rule change, Euro-denominated House Origin Cash and Customer Origin Cash would be (1) held in bank deposits, (2) allocated to outside investment managers, or (3) directly held/invested by the ICC Treasury Department.²⁵ Under scenarios (2) and (3), the investment managers or the ICC Treasury Department, as applicable, would invest the Euro-denominated House Origin Cash and Euro-denominated Customer Origin Cash pursuant to the Euro investment guidelines (changes to which are described above).

Fourth, the proposed rule change would also move the reference to ICC’s default position of holding U.S. Dollar-denominated Customer Origin Cash and House Origin Cash in its Federal Reserve Account from the ‘Investment Strategy’ subsection to the

²² Notice, 83 FR at 40814.

²³ CFTC Order, 83 FR at 35244-35245.

²⁴ Id.

²⁵ Notice, 83 FR at 40814.

amended ‘ICC Investment of Guaranty Fund and Margin Cash’ subsection under the proposed USD heading.²⁶ This change would allow ICC to consolidate, under the proposed USD heading, all of the provisions relating to ICC’s use of the Federal Reserve Account for holding U.S. Dollar-denominated Customer Origin Cash and House Origin Cash. As described above, the proposed rule change would also apply this ‘ICC Investment of Guaranty Fund and Margin Cash’ subsection to Customer Origin Cash.

Further in the proposed ‘USD’ heading, ICC would note that if it is unable to deposit U.S. Dollar-denominated Customer Origin Cash and House Origin Cash in its Federal Reserve Account, ICC’s Treasury Department would be able to hold or invest such cash as specified within the Treasury Policy.²⁷ The proposed rule change would also correct a typographical error by adding the verb “has” to the phrase “ICE Clear Credit arrangements.”²⁸

B. Changes Relating to Outside Investment Managements and Clean-Up Changes

To reflect ICC’s engagement of multiple outside investment managers the proposed rule change would remove reference to a specific outside investment manager in the ‘Outside Investment Management of Guaranty Fund and Margin Cash’ subsection.²⁹ The proposed rule change would also correct certain typographical errors in this section to improve readability, including removing the indefinite article “an” in the phrase “an alternative or additional outside investment managers”, adding the definite

²⁶ Notice, 83 FR at 40814.

²⁷ Id.

²⁸ Id.

²⁹ Id.

article “the” to the phrase “Investment Manager’s investment”, and changing “Directory of Treasury” to “Director of Treasury” in a footnote.³⁰

The proposed rule change would also remove language from the ‘Treasury Management for Client Business’ section that references the introduction of client trades to clarify that ICC has already commenced client clearing.³¹

III. Discussion and Commission Findings

Section 19(b)(2)(C) of the Act directs the Commission to approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to such organization.³² For the reasons given below, the Commission finds that the proposal is consistent with Section 17A(b)(3)(F) of the Act³³ and Rules 17Ad-22(b)(2), 17Ad-22(b)(3), and 17Ad-22(d)(3) thereunder.³⁴

A. Consistency with Section 17A(b)(3)(F) of the Act

Section 17A(b)(3)(F) of the Act requires, among other things, that the rules of ICC be designed to assure the safeguarding of securities and funds which are in the custody or control of ICC or for which it is responsible, and, in general, to protect investors and the public interest.³⁵

³⁰ Notice, 83 FR at 40814.

³¹ Id.

³² 15 U.S.C. 78s(b)(2)(C).

³³ 15 U.S.C. 78q-1(b)(3)(F).

³⁴ 17 CFR 240.17Ad-22(b)(2), (b)(3), and (d)(3).

³⁵ 15 U.S.C. 78q-1(b)(3)(F).

As discussed above, the proposed rule change would update the Treasury Policy in light of the CFTC Order permitting ICC to invest, subject to certain conditions, Euro-denominated Customer Origin Cash in French and German sovereign debt. Currently, ICC cannot hold Euro-denominated cash in its Federal Reserve account. Therefore ICC invests Euro-denominated House Origin Cash in certain foreign sovereign debt, but holds Euro-denominated Customer Cash at commercial banks in unsecured demand deposit accounts. By providing ICC an alternative to holding Euro-denominated Customer Origin Cash at commercial banks, where such cash is subject to the credit risk of the commercial bank, the proposed rule change would help ICC ensure the reliable investment of assets in ICC's control while at the same time avoiding subjecting such cash to the credit risk of the commercial bank, thereby providing ICC with an important alternative for the protection and safeguarding of Customer Origin Cash and House Origin Cash. And permitting ICC to use multiple outside investment managers to invest Euro-denominated Customer Origin and House Origin Cash on behalf of ICC would further help facilitate the safeguarding of such cash by allowing ICC to employ as many managers as it may need to make its investments and remove investment managers who underperform, which would facilitate ICC's ability to invest such cash in accordance with the Treasury Policy. The Commission believes that, when compared to credit risk at commercial banks, French and German sovereign debt is a reasonably safe investment, and therefore investment by ICC in such debt provides a safe alternative to deposit in commercial banks and would help assure the safeguarding of Euro-denominated House Origin Cash and Customer Origin Cash.

We note that, although permitting ICC to invest Customer Origin Cash through a reverse repo still exposes ICC to the credit risk of the counterparty to the reverse repo transaction, unlike placing the cash in an unsecured demand deposit account at a commercial bank, ICC would receive German and French Sovereign Debt as collateral against the repo counterparty's credit risk, thereby helping to mitigate the risk. Similarly, to the extent a custodian holding the collateral in connection with a reverse repo transaction entered insolvency proceedings, ICC would have a claim to specific securities rather than a general claim against the assets of the custodian, as it would have with respect to cash on deposit at a commercial bank account, which could put ICC in a better position to recover losses in case of insolvency proceedings. For these reasons, the Commission believes that ICC's investment of Euro-denominated Customer Origin Cash and House Origin Cash in French and German sovereign debt, under the conditions of the proposed rule change, would help ICC ensure the reliable investment of assets in ICC's control while at the same time helping to assure the safeguarding of such cash by reducing the exposure to counterparty credit risk from commercial banks.

By helping to assure the safeguarding of Customer Origin Cash and House Origin Cash, which CPs post to satisfy their clients' margin requirements and their own margin and GF requirements, the Commission also believes the proposed changes could help reduce risks to ICC's margin system and Guaranty Fund, which in turn could help ensure that ICC is able to continue providing its critical central counterparty services in the event of a CP default. By ensuring that the assets that comprise the margin and Guaranty Fund collected by ICC, in the form of Customer Origin Cash and House Origin Cash, are safely invested and held in a manner that will allow ICC to access such assets when

needed, the Commission believes that the propose rule change would help improve the overall effectiveness of ICC's margin system and Guaranty Fund as risk management tools. For the same reasons, the Commission believes the proposed rule change would, in general, help protect investors and the public interest.

Therefore, the Commission finds that the proposed rule change would assure the safeguarding of securities and funds in ICC's custody and control, and, in general, protect investors and the public interest, consistent with the Section 17A(b)(3)(F) of the Act.³⁶

B. Consistency with Rules 17Ad-22(b)(2) and 17Ad-22(b)(3)

Rule 17Ad-22(b)(2) requires that ICC establish, implement, maintain and enforce written policies and procedures reasonably designed to use margin requirements to limit its credit exposures to participants under normal market conditions and use risk-based models and parameters to set margin requirements and review such margin requirements and the related risk-based models and parameters at least monthly.³⁷ Rule 17Ad-22(b)(3) requires that ICC establish, implement, maintain and enforce written policies and procedures reasonably designed to maintain sufficient financial resources to withstand, at a minimum, a default by the two participant families to which it has the largest exposures in extreme but plausible market conditions.³⁸

As discussed above, the Commission believes that the proposed changes facilitating the investment of Euro-denominated Customer Origin Cash and House Origin Cash in French and German sovereign debt would improve the safeguarding of such cash,

³⁶ 15 U.S.C. 78q-1(b)(3)(F).

³⁷ 17 CFR 240.17Ad-22(b)(2).

³⁸ 17 CFR 240.17Ad-22(b)(3).

and would thereby help reduce risks to ICC's margin system and GF. As described above, the proposed rule change would provide ICC two reasonably safe investments for such cash – French and German sovereign debt – which ICC could use to maintain and preserve the cash in ICC's margin system and GF, which in turn could help ICC to maintain margin requirements to limit its credit exposures to participants under normal market conditions. Likewise, by improving the safeguarding and investment of the cash in the GF, which ICC collects from CPs to maintain such sufficient financial resources, the Commission believes the proposed rule change would help ICC to maintain sufficient financial resources to withstand, at a minimum, a default by the two participant families to which it has the largest exposures in extreme but plausible market conditions.

Therefore, for these reasons, the Commission finds that the proposed rule change is consistent with Rules 17Ad-22(b)(2) and 17Ad-22(b)(3).³⁹

C. Consistency with Rule 17Ad-22(d)(3)

Rule 17Ad-22(d)(3) requires that ICC establish, implement, maintain and enforce written policies and procedures reasonably designed to hold assets in a manner that minimizes risk of loss or of delay in its access to them and invest assets in instruments with minimal credit, market and liquidity risk.⁴⁰

As described above, the proposed rule change would allow the investment of Euro-denominated Customer Origin Cash and House Origin Cash in French and German sovereign debt, allowing ICC to avoid holding such cash in demand deposits at commercial banks. Moreover, the proposed rule change would prohibit investment in

³⁹ 17 CFR 240.17Ad-22(b)(2), (b)(3).

⁴⁰ 17 CFR 240.17Ad-22(d)(3).

French and German sovereign debt when such investment would not comply with the conditions and restrictions set forth in CFTC Regulation 1.25,⁴¹ the CFTC Order, and any other applicable exemptive orders. Such conditions and restrictions would, among other things, prohibit investment if the two year credit default spread of France or Germany exceeds 45 basis points (which the CFTC considered to approximate the risk level of the United States).⁴² Finally, the Treasury Policy's Euro investment guidelines would set a target of 100% of investment through overnight reverse repos, meaning a reverse repo transaction for which the agreed upon repurchase date is the business day immediately following the purchase date.

For all the reasons discussed above, the Commission believes that in facilitating investment in French and German sovereign debt with minimal credit risk and creating risk controls surrounding such investments, the proposed rule change would allow ICC to hold Customer Origin Cash and House Origin Cash in a manner that minimizes risk of loss or of delay in ICC's access to them and would allow ICC to invest such funds in instruments with minimal credit, market and liquidity risk.

Therefore, for these reasons, the Commission finds that the proposed rule change is consistent with Rule 17Ad-22(d)(3).⁴³

⁴¹ 17 CFR 1.25.

⁴² CFTC Order, 83 FR at 35243-35245.

⁴³ 17 CFR 240.17Ad-22(d)(3).

IV. Conclusion

On the basis of the foregoing, the Commission finds that the proposal is consistent with the requirements of the Act, and in particular, with the requirements of Section 17A(b)(3)(F) of the Act⁴⁴ and Rules 17Ad-22(b)(2), 17Ad-22(b)(3), and 17Ad-22(d)(3) thereunder.⁴⁵

IT IS THEREFORE ORDERED pursuant to Section 19(b)(2) of the Act⁴⁶ that the proposed rule change (SR-ICC-2018-009) be, and hereby is, approved.⁴⁷

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁴⁸

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⁴⁴ 15 U.S.C. 78q-1(b)(3)(F).

⁴⁵ 17 CFR 240.17Ad-22(b)(2), (b)(3), and (d)(3).

⁴⁶ 15 U.S.C. 78s(b)(2).

⁴⁷ In approving the proposed rule change, the Commission considered the proposal's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

⁴⁸ 17 CFR 200.30-3(a)(12).

[FR Doc. 2018-21585 Filed: 10/3/2018 8:45 am; Publication Date: 10/4/2018]