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COMMENT

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Received CFTC
Records Section
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Mr. David Stawick
Secretary
Commodity Futures Trading Commission
1155 21st Street, NW
Washington, DC 20581

RE: Determination whether the Singapore 180cst Fuel Oil swap serves a Significant Price Discovery Function

Dear Mr. Stawick:

IntercontinentalExchange, Inc. ("ICE") welcomes the opportunity to comment on the Commodity Futures Trading Commission's ("CFTC" or "Commission") notice of intent ("notice") to determine whether the Singapore 180cst Fuel Oil Swap ("SZS") serves a significant price discovery function.

ICE believes that the Singapore Fuel Oil swap ("SZS") does not serve a significant price discovery function, as described herein, and that the Commission may exceed its jurisdiction if it determines that these contracts serve as a significant price discovery contracts ("SPDC"). In addition to the absence of minimum liquidity thresholds and the lack of a material price reference precludes this contract from performing a significant price discovery role.

Background

In 2000, the Commodity Futures Modernization Act ("CFMA") created a system of tiered regulation to replace a "one size fits all" regulatory scheme. As part of the tiered regulatory scheme, Congress created exempt commercial markets ("ECMs"), which are principle to principle electronic trading platforms that serve sophisticated market participants. ECMs were designed to encourage electronic trading of derivatives. Given the sophisticated status of the participants, ECMs were subject to light touch regulation by the CFTC. The CFTC Reauthorization Act of 2008[1] expanded the CFTC's authority over ECMs that list contracts that serve a significant price discovery function. Congress directed the Commission to consider five criteria when making the significant price discovery determination: (1) Price Linkage; (2) Arbitrage; (3) Material Price Reference; (4) Material Liquidity; and (5) Other Factors. It is important to note that Congress gave the CFTC this authority over ECMs to capture two types of contracts: (1) contracts that trade with enough volume to impact trading on a designated contract

1 Title XIII of the Food, Conservation and Energy Act of 2008, Pub. L. No. 110-246, 122 Stat. 1623 (June 18, 2008).

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market ("DCM"); or (2) contracts that trade with enough volume to be quoted as an independent price reference by the public.[2] It is clear that - by giving the CFTC tailored authority - Congress intended to keep the CFMA's tiered regulatory structure. Further, as stated by the CFTC in it's 2007 Report on the Oversight of Trading on Regulated Futures Exchanges and Exempt Commercial Markets: "[t]he Commission believes that the CEA's current level of regulation is appropriate for ECM contracts relying on the §2(h)(3) exemption when trading volume remains low and prices are not *significantly* relied upon by other markets."[3]

It is against this backdrop that the Commission makes its determination whether the SZS Contract serves a significant price discovery function.

The Singapore 180cst Fuel Oil Swap

The SZS contract in the CFTC's notice of intent is a cash settled contract based on an index of the price of the Singapore high-sulfur fuel oil. The index is created by Platts' Asia-Pacific/Arab Gulf Marketscan. The price is derived from the arithmetic average of the means between the daily high and low price quotations for Singapore delivered high sulfur fuel oil.

As the name implies, the Singapore 180cst Fuel Oil Swap is not a United States Contract. 99.47% of SZS traders are based outside of the United States. ICE listed the contract in order to bring transparency and efficient execution to a voice brokered market in Asia. At the outset, the Commission should consider whether overregulation of this product will drive trading back overseas and to non-transparent venues.

The CFTC's Analysis

The CFTC believes that the SZS contract could potentially serve a significant price discovery function based upon three factors: (1) material liquidity; (2) material price reference; and (3) price linkage. ICE believes the SZS contract does not meet any of these tests.

Material Liquidity

To prove material liquidity, the Commission needs to determine that the contract traded on the ECM must trade with sufficient volume "to have a material effect on other agreements, contracts, or transactions listed for trading…on a designated contract

[2] The Joint Explanatory Statement of the Committee of Agriculture Conference, H.R. Rep. No. 1110 627, 110 Cong., 2nd Sess. at 978-86 (2008).

[3] Commodity Futures Trading Commission, *Report of the Oversight of Trading on Regulated Futures Exchanges and Exempt Commercial Markets* (October 2007)

market" or ECM. The Commission has issued guidelines stating "[l]iquidity is a broad concept that captures the ability to transact immediately with little or no price concession". Further, "in markets where material liquidity exists, a more or less continuous stream of prices can be observed and the prices should be similar," for example, "a market where trades occur multiple times per minute".[4] Finally, as Congress mandated in the Farm Bill, "the Commission *should not* make a determination that an agreement, contract, or transaction performs a significant price discovery function on the basis of the price linkage factor *unless* the agreement, contract, or transaction has sufficient volume to impact other regulated contracts or to become an independent price reference or benchmark that is regularly utilized by the public."[5]

In the notice of intent, the CFTC seems to have adopted a five trade-per-day test to determine whether a contract is materially liquid. It is worth noting that ICE originally suggested that the CFTC use a five trades-per-day threshold as the basis for an ECM to report trade data to the CFTC. This arbitrarily low threshold is appropriate for reporting purposes as it captures nearly every ECM contract, but it is at odds with Congress's intent that the CFTC include "material liquidity" in its requirements for significant price discovery. If the CFTC has decided to abandon its rulemaking on Significant Price Discovery Contracts, then it should, at the very least, propose revisions Part 36 in order to allow the public to comment on whether the CFTC's *new* threshold meets Congress' intent in promulgating the Significant Price Discovery Test of the Farm Bill.

Moreover, the statistics requested by the CFTC and provided by ICE have been misinterpreted and misapplied. First, these trades-per-day statistics requested by the CFTC and provided by ICE include transactions that were not even executed on the ICE 2(h)(3) platform and therefore make no contribution to price discovery. Rather, these transactions were executed via voice brokers in the over the counter market and submitted to ICE sometime after-the-fact solely for clearing purposes. For the SZS Singapore swap, only about 69% of all trades were actually executed on the ICE platform. However, *volume*, rather than *number of trades*, is a much more meaningful indicator of actual liquidity and therefore price discovery. In deciding whether or not to participate in a market, traders consider volume, not number of trades. On a volume-basis, only about 59% of all SZS volume was actually executed on the ICE platform.

Second, the CFTC's figures, as requested of and provided by ICE, include trades made in all 60 months of each contract. The more appropriate method of determining liquidity is to examine the activity in a *single* traded month or strip of a given contract. The merit of this argument is obvious when you consider that liquidity in a January contract is of no help to a trader who needs to liquidate an October position. For the SZS

4 Appendix A to Part 36, 17 C.F.R. 36 (2009).

5 Title XIII of the Food, Conservation and Energy Act of 2008, Pub. L. No. 110-246, 122 Stat. 1624 (June 18, 2008).

Singapore swap, only 37% of the trades actually executed on the ICE platform occurred in the single most liquid, usually prompt, month of the contract. However, again, from the more important volume-standpoint, only 30% of all SZS volume actually executed on the ICE platform occurred in the single most liquid, usually prompt, month of the contract.

The trades-per-day statistics used by the CFTC must be adjusted for both of the factors described above before even considering whether or not a "more or less continuous steam of prices" can be observed. According to the statistics cited by the CFTC, the SZS Singapore swap traded an average of 30 times per day, but only 26% (69% x 37%) of these trades (and an even lower 18% of total volume) were actually executed on the ICE platform in the single most liquid, usually prompt, month of the contract. Given an eight hour trading day[6], this means that the SZS Singapore swap traded only about once every 62 minutes. Clearly, such a low level of liquidity does not represent an "ability to transact immediately" or "a more or less continuous stream of prices" and certainly not "a market where trades occur multiple times per minute." In comparison, the single most liquid, usually prompt, month of the ICE Henry Hub LD1 natural gas contract traded, on average, over 4,000 times per day on the ICE platform alone.

In conclusion, it is clear that the SZS Singapore contract does not meet the material liquidity standard as contemplated by Congress or the CFTC in its SPDC rulemaking.

Material Price Reference

The second basis for the Commission's determination is that the SZS contract serves as a material price reference. In this determination, Congress instructed the Commission to consider "the extent to which, on a frequent and recurring basis, bids, offers, or transactions in a commodity are directly based on, or are determined by referencing, the prices generated" by the ECM. The Commission elaborates on this by saying that it will rely on one of two sources of evidence, direct or indirect, that the contract is a material price reference. A direct reference would be whether the cash market quotes the ECM contract. An indirect reference would be whether an industry publication quotes the ECM's contract's price.

For the SZS contract, the CFTC relies on one reason for material price reference: (1) that "the Commission's ECM study, in general, stated that certain market participants referred to ICE as a price discovery market for certain energy contracts "[7] and or (2) that

[6] Note that ICE's OTC markets are actually open 22 hours.
[7] See, *e.g.*, 72 FR 53728 (October 20, 2009) (the Notice of Intent for the SZS contract). This follows every other power and basis swap determination.

ICE uses an exclusive index to determine one component of the basis swap.[8] The first reason proposed by the CFTC has been used as a justification for nearly every notice of intent the CFTC has issued for significant price discovery contracts. This argument is nearly impossible to respond to as the ECM report did not mention the SZS as a potential significant price discovery contract. It is hard to say which market participants made this statement *in 2007 or the contracts that were referenced.* Congress, in promulgating the Farm Bill, ordered the CFTC to undertake a very important analysis of the OTC energy markets. Basing a material price reference determination on general statements made in a two year old study does not seem to meet Congress' intent that the CFTC use its considerable expertise to study the OTC markets. Moreover, this ephemeral analysis does not allow the public to comment effectively and borders on being arbitrary.

The SZS contract settles on the Platts' Asia-Pacific/Arab Gulf Marketscan index. Price discovery occurs in the physical trading of the Singapore fuel oil, not in the cash settled swap that references the index.

The SZS is not a U.S. based contract

In the Farm Bill, Congress gave the Commission the authority to consider other factors that the Commission deems important and there are at least three unique factors worth noting with regard to the SZS contract. First, the SZS contract is an *Asian* fuel oil swap traded overwhelmingly by Asian oil traders. Specifically, *99.5%* of the SZS traders are *not* in the United States. Second, the swap settles on a cash market index based on delivery of fuel oil into Singapore, 9,000 miles from the U.S.

Third, the SZS contract, as well as other non-US contracts, is currently listed on the ICE ECM and utilized by Asian participants largely because the level of U.S. regulation on such a clearly non-U.S. market has been reasonable to date. This rational and differentiated approach, as opposed to enforcing a "one size fits all", is a leading reason why U.S. companies have been successful in hosting and operating foreign markets. Over regulating foreign markets such as the SZS Singapore swap could cause Asian traders to migrate to a non-U.S. platform or retreat back to the voice brokered OTC market. In either case, the CFTC loses all data transparency and market oversight benefits it enjoys today.

Given these very strong arguments and limited agency resources, the CFTC should not deem any such foreign market swap an SPDC.

[8] *Id.*

Conclusion

It is clear that SZS does not serve as a material price reference. Further, the SZS contract does not meet the CFTC's criteria for material liquidity. On this basis, the Commission should not deem this contract as a significant price discovery contract.

Finally, it is important to note that Congress ordered the Commission to review the electronic OTC markets for contracts that serve a significant price discovery function. Overreaching in this process could force OTC trading back to the opaque voice brokered markets. It is important for the Commission to remember that Exempt Commercial Markets perform a very important function in introducing transparency and credit intermediation to the OTC markets.

Thank you for the opportunity to comment.

Sincerely,

R. Trabue Bland
Director of Regulatory Affairs
Assistant General Counsel