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

COMMENT

RE: Comments on Proposed Rules Implementing the CFTC Reauthorization Act of 2008.

Dear Mr. Stawick:

IntercontinentalExchange, Inc. (ICE) welcomes the opportunity to comment on the Commission's proposed rulemaking on Significant Price Discovery Contracts on Exempt Commercial Markets. The Commission's proposed rulemaking would implement the CFTC Reauthorization Act of 2008[1] and provide exempt commercial markets with self regulatory authority with respect to contracts that serve a significant price discovery function ("SPDC").

ICE was established in 2000 as an over-the-counter (OTC) market. Since that time, ICE has grown significantly, through organic market growth fostered by product, technology and trading innovation, and by acquisition of futures exchanges that have broadened its product offerings. Today, ICE operates a leading global marketplace in futures and OTC derivatives across a variety of product classes, including agricultural and energy commodities, foreign exchange and equity indexes. Commercial hedgers use our products to manage risk and investors provide necessary liquidity to the markets. Headquartered in Atlanta, ICE has offices in New York, Chicago, Houston, London, Singapore and Calgary.

ICE hosts four separate markets on its electronic trading platform: an OTC energy market and three regulated futures exchanges. ICE's OTC market operates under the CEA as an "exempt commercial market," or ECM. As an ECM, ICE's OTC market would be subject to the proposed rules.

Market participants — including energy producers, distributors and consumers — have benefited significantly from the regulatory flexibility embodied in the Commodity Futures Modernization Act (CFMA) through the ECM structure established under section 2(h)(3) of the Act. Section 2(h)(3) has facilitated the development of robust and transparent OTC markets where only opaque markets had previously existed,

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

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and has permitted commercial and professional market users to hedge risk in a more efficient and cost effective manner. Energy market participants benefit, to a degree unmatched by other derivative markets, from the fierce competition among multiple exchanges, clearinghouses, and brokers.

As the Commission noted in its October 2007 Report on the Oversight of Trading on Regulated Futures Exchanges and Exempt Commercial Markets[2] (ECM Report), ECMs serve an important role in the Commission's multi-tiered regulatory structure. In devising this regulatory structure, Congress recognized that there are substantial differences between ICE's OTC market, other portions of the OTC market, and designated contract markets. ICE's OTC market, by law, is a "principals only" market in which participants must execute trades in their own names on the system. In addition, the market is available solely to sophisticated market participants, and unlike other OTC market venues, ICE maintains trading records of all transactions that occur in its marketplace for prompt regulatory review.

As ECMs have grown and developed since passage of the CFMA, however, new regulatory challenges have emerged, and ICE supports Congress and the Commission's efforts to create a tailored approach to ECM regulation. Against this backdrop, ICE offers the following comments for consideration by the Commission in adopting final ECM rules.

<u>Proposed Core Principle IV</u> --Position Limitations or Accountability.

Volume Accountability Test

In general, ICE agrees with the Commission's articulation of the ECM's responsibilities under Core Principle IV to set position limits or accountability rules for SPDCs. In the acceptable practices for Core Principle IV, the Commission proposes that ECMs with "clearable" contracts (contracts that may be executed bilaterally betweens parties or cleared, depending on the preference of the trading party) adopt volume accountability levels for bilaterally traded contracts equal to the spot month speculative position limit that would be adopted for the cleared version of the contract. The acceptable practice goes on to provide that in enforcing a volume accountability level, ECMs would keep track of each trader's uncleared/bilaterally traded SPDC transactions on a net basis, with netting of uncleared/bilaterally traded positions only being permitted if the uncleared transactions were conducted with the same counterparty. In the event that a particular traders uncleared/bilaterally traded contracts exceeded the accountability

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2 http://www.cftc.gov/stellent/groups/public/@newsroom/documents/file/pr5403-07_ecmreport.pdf

level, the proposed rules would require the ECM to initiate an investigation to determine whether the trading activity is justified, and following the general recommendations for position accountability, could require the ECM to require traders to reduce the volume of uncleared trades.

ICE recommends that the Commission not adopt this acceptable practice in its final rulemaking. The Commission's rationale for requiring the volume accountability test is that "uncleared transactions in SPDCs potentially play an important role in risk management strategies and price formation."[3] This is a marked change from the Commission's ECM Report, which observed, "[T]here [does not] appear to be a widespread call for further regulating the voice-broker or bilateral OTC markets due to the lack of price discovery occurring on these markets and the ability of the Commission to receive certain cleared pricing data and other information regarding these transactions from market participants on a case-by-case basis."[4] Following this, Congress gave ECMs reasonable discretion to taking into account the differences between cleared and uncleared transactions when complying with Core Principle IV.[5]

Market participants need to have legal certainty with regard to bilateral hedges. The proposed volume accountability levels and accompanying potential for a third party, ICE, to interfere with a bilateral transaction at any point in the life of the transaction challenges this legal certainty. Market participants would likely take these trades off exchange simply to avoid this legal uncertainty, thereby reducing ECM liquidity and transparency to the regulator and eliminating the Commission's ability to easily obtain integrated market data from the ECM. Importantly, the proposed volume accountability levels would harm innocent counterparties, who have entered into a transaction with a party who at some point exceeded the volume accountability test. Moreover, as the Commission has repeatedly pointed out, the Large Trader *Position* Report is the cornerstone of DCM market monitoring. The focus is on positions held, not volume transacted. Even within DCM core principles, there is no identified need or corresponding regulation that requires specific scrutiny of firms trading above a volume threshold. Such a requirement for ECMs concerning bilateral volumes is therefore unprecedented and, more importantly, suspect in its utility in that non-ECM volumes would not be known by the ECM and would likely be where transactions of this nature are driven by such a requirement.

To be clear, ICE is not arguing that bilateral markets on ECMs should go unmonitored -- they would be affirmatively monitored in connection with administering position accountability levels and position limits in connection with the cleared contracts as DCMs do today. However, we do not believe that there should be a separate

3 73 FR 75888, 75896 (December 12, 2008)
4 ECM Report, pg. 17.
5 Public Law 110-246 at sec 13201 (2008)

regulatory accountability regime applied to bilateral contracts. The volume accountability regime would offer very little regulatory benefit to the Commission while encouraging participants to take bilateral transactions to opaque portions of the OTC market.

On ICE's ECM, many contracts are clearable. Of those contracts for which ICE offers clearing, an overwhelming and growing majority of contracts are traded on a cleared basis rather than traded bilaterally. In fact, in January 2009, over 98% of all Henry Hub swap volume executed on the ICE Platform was cleared. Moreover, of the less than 2% of total volume that was bilaterally executed (uncleared), it is possible and even likely that some portion of such trading volume was later blocked into ICEBlock or NYMEX Clearport to be cleared and, therefore, would have been included in the ICE or NYMEX position limit regime, respectively. Neither ICE nor NYMEX have any way of avoiding this double counting of bilateral volumes.

The small percentage of bilateral transactions that are executed on the ICE Platform is typically between commercial participants who have longstanding ISDA master agreements and established credit lines in place. Even among this subset of commercial firms, bilaterally executed transactions accounted for less than 10% of their total Henry Hub swap volume executed on the ICE Platform in January 2009. Further, the Commission should note the following key aspects of the ICE trading platform that render bilateral volumes less relevant from a market integrity perspective:

1. *All bids and offers are anonymous* and executed in first in first-in, first-out order; in other words, a trader should not know who the potential counterparty is when transacting bilaterally.
2. *All orders entered into the ICE Henry Hub swap market must be clearable.* In other words, a trader cannot enter a bilateral-only order and has no means to ensure or even expect bilateral execution.
3. *The settlement method, cleared or bilateral, for a given transaction, is not revealed to the trader until after the trade is executed.* (Settlement method is determined automatically by the ICE Platform at the moment of execution based upon (i) preset preferences of the parties for cleared or bilateral trading with regard to the other party (Note: if one party prefers cleared settlement and the other party prefers bilateral settlement, the trade is cleared), and (ii) the level of unused bilateral credit remaining in each party's credit line with the other.

In addition, the specific methodology proposed by the Commission for implementing the Volume Accountability Test is problematic. For example, in the Henry Hub swap market, a trader has no way of knowing prior to execution who its counterparty would be or whether settlement would be cleared or bilateral. Thus, there is no way for a trader to force bilateral settlement generally let alone with a specific counterparty. Therefore, a

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Volume Accountability Test that only permits netting of trades with the same bilateral counterparty is problematic and potentially misleading. Bilateral volumes among multiple counterparties should be equally available to net as with the same counterparty.

Self Regulatory Obligations

In the proposed guidance to Core Principle IV, the Commission proposes that the ECM establish the same speculative position limits for SPDCs that are "economically equivalent" to contracts traded on a DCM. ICE recommends that the Commission not adopt this acceptable practice.

As the Commission has noted, self-regulatory organizations ("SROs") serve as "front line" regulators in derivatives' markets.[6] As such, SROs should be given deference in monitoring their markets. The Commission's proposed acceptable practice would permanently shift ECMs' self-regulatory obligations to one DCM for economically equivalent contracts and concentrate self-regulatory responsibilities in possibly one entity. The Reauthorization Act clearly indicates that Congress intended that ECMs have discretion in discharging their self regulatory obligations by, for example, allowing ECMs to take into account the difference between cleared and uncleared contracts when complying with certain core principles.[7] To be clear, ICE is not suggesting that there should not be a high correlation between the position limits set in each market, or even a presumption in regulatory dialog with the CFTC that they should be the same. ICE is merely objecting to the automatic nature of the process and the opportunity for a dominant DCM to potentially use its position limits in an anti-competitive manner.

Further, as comments in previous rulemakings have noted, determining "economic equivalency" between futures contracts is difficult.[8] The Commission should recognize that competing markets that list economically equivalent contracts may attract completely different market participants. ICE's ECM and CME's market participants do overlap, but they are not the same, partly because ECM participants must be Eligible Commercial Entities.

In addition, the proposed acceptable practices do not allow for the possibility that the ECM is the dominant market. For example, an ECM could list an SPDC which captures most of a market's liquidity, while a DCM could list an "economically equivalent" contract. Under the proposed acceptable guidance, however, the DCM would determine the position limits and position accountability levels for the dominant ECM.

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6 71 Fed. Reg. 38740 (June 7, 2006).

7 Public Law 110-246 at sec. 13201.

8 *See,* Comment of the Chicago Mercantile Exchange, submitted February 1, 2008. http://www.cftc.gov/stellent/groups/public/@lrfederalregister/documents/frcomment/07-014c038.pdf

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The automatic linking of DCM and ECM position limits could also lead to abusive and anticompetitive practices by a dominant DCM market. For example, a DCM with dominant market share could set position limits so low that it would effectively strangle the ECM's market, eliminate competition in the process, and then re-adjust position limits to appropriate levels after having drained liquidity from the ECM's markets. ICE's respectfully submits that the very essence of SRO responsibilities is to allow the SRO to self-regulate, and that appropriate position limits and accountability levels can be set in dialog with the Commission which can itself take into account existing position and accountability levels at the DCM in that dialog.

Position Accountability Levels

The Commission has proposed that ECMs adopt non-spot month and all month-combined position limits in lieu of position accountability levels. ICE notes that DCMs do not have a similar acceptable practice and there is not industry consensus on the value of position limits versus position accountability levels.[9] Position accountability levels can serve a valuable for managing positions in non spot months. For example, CME has spot month position accountability levels and all month position accountability levels for some exempt commodities and position limits for others.[10] ICE believes that the Commission should address this acceptable practice in a separate rulemaking where DCMs can have the opportunity to comment on adopting position limits for non-spot months.

Period for Compliance

The Commission proposes that ECMs have ninety calendar days for compliance following the determination of SPDC, and fifteen calendar days to comply following each subsequent determination of an SPDC. Generally, this is sufficient time for the ECM to comply with the core principles. However, because many clearing firms outsource large trader reporting to third parties, the Commission should consider whether fifteen calendar days is enough time for clearing firms to meet the reporting requirements. ICE would respectfully request that more time be allocated for compliance to ensure that clearing firms can meet the reporting requirements and that no disruptions to markets occur. ICE believes that 45 days would be sufficient.

9 *See, e.g.*, comments pursuant to the Commission's proposed changes to Part 150. 72 Fed. Reg 65483 (November 21, 2007).

10 http://www.nymex.com/rule_main.aspx?pg=13

Conclusion

Again, ICE commends the Commission for its work in implementing the Reauthorization Act. The Reauthorization Act strikes a fair balance in regulating ECMs while recognizing the benefits that ECMs offer to the derivatives markets.

Sincerely,

Johnathan H. Short
Senior Vice President and General Counsel