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Introduction

Chairman Peterson, Ranking Member Lucas, I am Johnathan Short, Senior Vice President and General Counsel of IntercontinentalExchange, Inc., or "ICE." We are grateful for the opportunity to provide comments on the "discussion draft" of the Derivatives Markets Transparency and Accountability Act (DMTA).

ICE fully supports the goal of the DMTA to "bring transparency and accountability to commodity markets." Over the past decade, we have worked with regulators both in the United States and abroad to achieve this end and appreciate the opportunity to work on additional improvements.

As background, ICE operates three regulated futures exchanges: ICE Futures Europe, formerly known as the "International Petroleum Exchange," is regulated by the U.K. Financial Services Authority (FSA). ICE Futures U.S., previously known as "The Board of Trade of the City of New York (NYBOT)" and the New York Clearing Corporation are both regulated by the CFTC. ICE Futures Canada, which was previously called the Winnipeg Commodity Exchange, is regulated the Manitoba Securities Commission. In addition, ICE operates an over-the-counter (OTC) energy platform as exempt commercial market, as defined by the Commodity Exchange Act. On these exchanges, ICE offers futures and options contracts on energy products (including the benchmark Brent and WTI contracts), agricultural commodities, currencies and equity indexes.

ICE has worked to provide transparency to a varied array of markets. For example, ICE brought transparency to OTC energy markets nearly a decade ago, with a digital platform that transformed the marketplace from an opaque, telephone-based network of brokerages to a global market with real-time prices on electronic trading screens. In its 2007 State of the Markets Report, Federal Energy Regulatory Commission (FERC) observed that ICE "provides the clearest view we have into bilateral spot markets."[1]

[1] Federal Energy Regulatory Commission, 2007 State of the Markets Report, pg. 9 (Issued, March 20, 2008).

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In 2002, in response to the credit and counterparty risk crisis that were then gripping the energy markets, we introduced clearing into the OTC energy markets. Cleared contracts now account for more than 90 percent of ICE's OTC business. Believing that centralized clearing is an essential next step in stabilizing the credit derivatives market, since last summer ICE has been working with the Federal Reserve System, the New York Banking Department and a number of industry participants to develop a clearing solution for credit default swaps (CDS).

Last May, as part of the Farm Bill reauthorization, Congress provided the CFTC with greater oversight of electronic OTC markets, or Exempt Commercial Markets. The new law provides legal and regulatory parity between fully regulated futures exchanges and OTC contracts that serve a significant price discovery function[2], while also recognizing and preserving the role of OTC markets in providing innovation and customization. ICE supported this legislation, and we remain grateful for this Committee's leadership during that debate.

Because ICE operates markets in both domestic and foreign jurisdictions, ICE is keenly aware of the global nature of most commodity and financial derivative markets. Furthermore, ICE is committed to facilitating global regulatory cooperation and the implementation of best practices in financial markets around the world. As the global nature of this financial crisis illustrates, systemic market problems cannot be solved independently, and solutions will require both close coordination and cooperation between governments of major developed nations and a willingness to implement best practices regardless of their source of origin. Combined with a commitment to open markets, such an approach will be the best way forward toward solving the problems that have impacted economies around the world.

We offer our comments on several provisions in the bill in the spirit of finding solutions that will achieve the stated purpose of improving transparency and accountability in commodity markets.

Section 3 - Foreign Boards of Trade

Earlier last month, the G30's Working Group on Financial Reform, led by Chairman Paul Volcker, published its Framework for Financial Stability. Core recommendation 2 states, "The quality and effectiveness of prudential regulation and supervision must be improved. This will require better-resourced prudential regulators and central banks operating within structures that afford much higher levels of national and international policy coordination." Recommendation 6b, on regulatory structure, states, "In all cases, countries should explicitly reaffirm the insulation of national

[2] This provision of the Farm Bill is commonly referred to as the "Closing the Enron Loophole Act."

regulatory authorities from political and market pressures and reassess the need for improving the quality and adequacy of resources available to such authorities."

By supporting coordination and information sharing among international regulators, the foreign board of trade provision in the DMTA, advances the G30's recommendations. We are concerned; however, that one aspect of that provision could limit competition between domestic and foreign exchanges and ultimately threaten cooperation between domestic and foreign regulators, and indeed domestic and foreign governments, in implementing uniform standards to improve markets.

Since 2006, ICE has worked with the United Kingdom's Financial Services Authority to provide the CFTC with visibility into markets traded on its foreign board of trade to allow the CFTC to properly surveil domestic regulated markets. On June 17, 2008, the CFTC revised the conditions under which ICE Futures Europe operates in the United States by amending the "no-action relief letter" that permits that exchange to have direct access to U.S. customers for its WTI Crude Oil Futures Contract. The amended letter conditioned ICE Futures Europe's direct screen based access on the adoption of U.S. equivalent position limits and accountability levels, together with reporting obligations, related to contracts that are linked to the price of a U.S. designated contract market price. Since October, ICE Futures Europe has been complying with the revised no action letter.

Section 3 of the DMTA essentially codifies the conditions set forth in the CFTC's revised no-action letter for ICE Futures Europe, with one important exception. Unlike the requirements applicable to domestic exchanges, Section 3 requires foreign exchanges to adopt position limits for the affected contract taking "*into consideration the relative sizes of the respective markets"*. This provision discriminates against foreign exchanges, and would effectively prevent them from attaining sufficient market liquidity to compete with domestic exchanges as all competitors would by definition start out with little or no market share. In addition, domestic exchanges could be impacted through the adoption of similar provisions of law in foreign countries which have a larger relative share of the underlying commodity market.

In recent years, the only effective competition in the futures industry has come from foreign exchanges and exempt commercial markets. That competition has led U.S. exchanges to transition markets to transparent electronic trading, with full audit trails and improved risk management through straight through processing. It has also resulted in more efficient markets bringing about many benefits for market participants such as lower trading costs and tighter bid/ask spreads. With one exchange in control of more than 97 percent of U.S. futures market, competition is more important than ever. Requiring foreign markets to set position limits according to respective market size would effectively bar foreign exchanges from competing in the U.S. , would likely be

viewed was extraterritorial regulation by foreign market regulators, and would be inconsistent with the higher level of international policy coordination contemplated by the G30 policy recommendations. ICE respectfully requests that this particular provision of Section 3 be reconsidered for the broader policy goals that are sought to be achieved by the G30 policy recommendations and in recognition of the fact that no single piece of legislation adopted here or elsewhere will achieve its ends unless appropriate standards are adopted on an international basis.

Section 6 -Trading Limits to Prevent Excessive Speculation

ICE's U.S. subsidiary, ICE Futures U.S. (formerly the New York Board of Trade) is a designated contract market regulated by the CFTC. Among the products it lists for trading are three international soft commodities — coffee, world sugar and cocoa — and it is the pre-eminent market for price discovery of these commodities. None of these commodities is grown in the United States or is subject to domestic price support programs. Moreover, none of them was the subject of hearings last year conducted by congressional committees or reviews by the CFTC into the rise and fall of certain commodity prices. Because they are liquid contracts traded on a designated contract market, our futures and options contracts in these commodities have been subject to position accountability levels and spot month position limits that have been established and administered by the Exchange for more than a decade without incident. Under the terms of the standardized futures contracts, ICE Futures U.S. also regulates physical delivery of those three international commodities from ports or warehouses located in more than two dozen foreign countries around the world.

Section 6 of the proposed legislation fails to distinguish between ICE's international agricultural contracts and the domestically-grown agricultural commodities that we believe were the bill's intended subjects. Specifically, the legislation would require the CFTC to set position limits on the number of futures and option contracts that a person could hold in any one futures month of a commodity, in all combined futures months of a commodity, and in the spot month. In contrast, ICE Futures U.S. sets limits for its coffee, sugar and cocoa contracts based on its extensive experience with these markets.

In addition, the proposed legislation would amend the Commodity Exchange Act core principles applicable to designated contract markets like ICE Futures U.S. by eliminating the availability of "position accountability" levels for speculators in international agricultural commodities. As noted previously, ICE Futures U.S. has set and administered position accountability levels in its internationally-based products for over a decade. For example, through its market oversight, ICE Futures U.S. has been able to respond to market conditions and the needs of its users in a flexible manner, while maintaining transparent and liquid markets relied upon throughout the world. This

provision, if implemented, would replace ICE Futures U.S.'s strong market surveillance role with an inflexible regime that would be established, and possibly administered, by the CFTC. This could very well drive business to London, Brazil and the Far East where these products already trade on established futures markets. We do not believe this was the drafters' intent.

Section 6 - Limitations on index traders

Section 6 defines bona fide hedging in a way that would prohibit index traders from taking a position in excess of position limits. This would be a significant change in market structure and will have an immediate and deleterious impact. A recent market study performed by Informa examined the impact of index funds on market volatility. The study employed both Granger causality and vector auto-regression tests and determined ***that there was no link between index funds and market volatility.*** Greatly reducing the participation of index funds in the market would be disadvantageous to the market at-large and would most likely only benefit the very largest participants in a given market. In a soft commodities market (e.g. coffee, sugar or cocoa), the removal of this additional liquidity could potentially enable a single large entity or a small group of entities to wield considerable influence on the market dynamics.

Section 9 requires the CFTC to study the impact of commodity "fungibility" and whether there should be "aggregate" position limits for similar agriculture or energy contracts traded on DCMs, DTEFs, 2(g) and 2(h) markets. Sec. 10 requires a GAO study of international regulation of energy commodity markets. Both reports are due in a year. ICE supports these studies without reservation, and we believe this legislation would be improved if it were informed by equally thorough reports on the issues we have discussed today.

Section 16 – Limitation on Ability to Purchase Credit Default Swaps

Section 16 of the bill would prohibit trading in credit default swaps without ownership of the underlying reference obligation. This provision is problematic on several levels.

First, CDS perform an important market function in allowing parties to hedge credit risk. Section 16 is titled "Limitation on Eligiblity to Purchase a Credit Default Swap." However, the language in subsection (a) prohibits parties from "entering into a credit default swap" unless they own the underlying bonds. As with all trading markets, another party must be willing to assume the hedger's risk; therefore, Section 16 would likely end the CDS market in the United States due to the inability of hedgers to find counterparties legally able to "buy their risk". This would be counterproductive, as a transparent and stable CDS market is important for the recovery of financial markets.

Furthermore, not all credit risk has a tailored credit default swap. Section 16 would prohibit parties from hedging default exposure by purchasing credit default indices, unless the party owned every underlying bond in the index.

Second, ICE believes that the goals of transparency and mitigation of counterparty credit risk and systemic risk can be achieved through central clearing of CDS and through resulting public and regulatory transparency. Section 16 would run counter to this goal as it would impair the liquidity needed to efficiently manage risk within a clearinghouse in the event of a default or similar event. ICE respectfully requests that the Committee consider eliminating this provision of the draft bill.

During the financial crisis, as cash markets evaporated, and markets for commercial paper, corporate bonds and other debt instruments dried up, the CDS market has remained liquid, offering lenders and investors a way to hedge risk and — just as important — a market-based, early-warning price discovery function. Broader availability of credit protection can encourage sovereign and corporate lending. As lenders and investors consider ways to improve credit risk evaluations, CDS spreads have proven to be more reliable indicators of an institution's financial health than credit agency ratings.

Finally, on the note of global cooperation, last week in Davos, E.U. Financial Services Commissioner Charlie McCreevy said he would not support a ban on trading credit default swaps unless the party held a position in the underlying bonds. Prohibiting this trade in the United States will almost certainly lead to a wholesale migration of the CDS marketplace overseas, outside the reach of U.S. regulators and this Committee. We do not believe that is the intent of this legislation.

Conclusion

ICE is a strong proponent of open and competitive derivatives markets, and of appropriate regulatory oversight of those markets. As an operator of global futures and OTC markets, and as a publicly-held company, we understand the essential role of trust and confidence in our markets. To that end, we are pleased to work with Congress to address the challenges presented by derivatives markets, and we will continue to work cooperatively for solutions that promote the best marketplace possible.

Mr. Chairman, thank you for the opportunity to share our views with you. I am happy to answer any questions you may have.