**WRITTEN TESTIMONY OF CHARLES A. VICE,
PRESIDENT AND CHIEF OPERATING OFFICER
INTERCONTINENTAL EXCHANGE, INC.
BEFORE THE JOINT HEARING OF COMMITTEE ON AGRICULTURE
NUTRITION, AND FORESTRY AND THE APPROPRIATIONS
SUBCOMMITTEE ON FINANCIAL SERVICES AND GENERAL
GOVERNMENT OF THE
UNITED STATES SENATE**

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Chairman Durbin and Chairman Harkin, Ranking Members Chambliss and Brownback, I am Chuck Vice, President and Chief Operating Officer of the IntercontinentalExchange, Inc., or "ICE." We very much appreciate the opportunity to appear before you today to give our views on energy markets.

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, Winnipeg and Calgary.

ICE owns and hosts four separate markets on its electronic trading platform – three regulated futures exchange subsidiaries which were individually acquired over the last seven years and one over the counter energy market, which operates under the Commodity Exchange Act (CEA) as an "exempt commercial market," or ECM. ICE's regulated futures exchanges include ICE Futures Europe, formerly known as the "International Petroleum Exchange", which is a Recognized Investment Exchange, or RIE, headquartered in London and under the supervision of the UK Financial Services Authority (FSA); ICE Futures US, formerly known as "The Board of Trade of the City of New York (NYBOT)," which is a CFTC-regulated Designated Contract Market (DCM) headquartered in New York; and ICE Futures Canada, formerly known as the "Winnipeg Commodity Exchange", which is regulated by the Manitoba Securities Commission and headquartered in Winnipeg, Manitoba.

ICE has always been and continues to be a strong proponent of open and competitive markets in energy commodities and related derivatives, and of appropriate regulatory oversight of those markets. As an operator of global futures and OTC markets and as a publicly-held company, we strive to maintain the utmost confidence in the integrity of our markets and in the soundness of our business model. To that end, we have continuously worked with the CFTC, the FERC, and regulatory agencies abroad in

order to ensure that they have access to all relevant information available to ICE regarding trading activity on our markets and we will continue to work with all relevant agencies in the future.

ICE Futures Europe

I would like to take the opportunity today to discuss ICE's UK exchange subsidiary, ICE Futures Europe. ICE Futures Europe, formerly known as the International Petroleum Exchange (IPE), was formed in 1981 and acquired by ICE in 2001. Since its formation, ICE Futures Europe has operated as a self regulatory organization, and since 1986, has operated as an RIE under the supervision of the UK Financial Services Authority. In this regard, ICE Futures Europe is the UK equivalent of what is known as a designated contract market, or DCM, in the United States, and is regulated by the equivalent of the Commodity Futures Trading Commission, or CFTC.

As the home of the Brent Crude Futures contract and the Gas Oil Futures Contract, ICE Futures Europe is, and has been since its inception, the leading energy futures exchange in Europe. Though a subsidiary of ICE, ICE Futures Europe has its own majority independent board and separate regulatory and operational staff. This degree of separateness from the parent group is mandated by the FSA in order for the exchange to maintain its status as a recognized body and self regulatory organization.

It is important to note that ICE Futures Europe, like the leading U.S. exchanges, is a global exchange. It is authorized to provide trading access in 51 jurisdictions around the world. ICE Futures Europe's customer base includes the largest energy companies and investment banks in the world, and its flagship contract, the Brent Crude Oil futures contract, is a global benchmark for the price of crude oil. In addition to its energy contracts, ICE Futures Europe partners with and hosts the European Climate Exchange, the largest pan-European exchange for carbon emissions trading.

Regulation of ICE Futures Europe

ICE Futures Europe is a Recognized Investment Exchange, subject to the regulation of the FSA. Much like the CFTC, the FSA is a principles-based regulator. As such, ICE Futures Europe must comply with core principles, which are similar to those imposed on CFTC regulated designated contract markets. Further, as part of its regulatory structure FSA incorporates the European Union's Markets in Financial Instruments Directive's (MiFID) principles. MiFID serves as regulatory backbone for the thirty-member states of the European Economic Area. The FSA has been recognized globally for its leadership in global derivatives market regulation.

As a recognized investment exchange supervised by the FSA, ICE Futures Europe has a robust market-monitoring program. Like U.S.-based exchanges, ICE Futures Europe has detailed exchange rules to prohibit misconduct, with which members must comply, as well as enforcement authority that penalizes misconduct.

ICE Futures Europe monitors trading on its markets on a real-time basis. Trained staff supervise our markets every hour of the day. They use a variety of market-supervision tools and are responsible for ensuring that there is a 'fair and orderly' market at all times. Our staff reviews trading activity each day to identify any unusual trading patterns that warrant further investigation. Our systems maintain a detailed audit trail of every order entered and every trade executed and allow compliance experts to drill into trading activity in great detail.

We conduct large trader reporting which obliges members to report to the exchange on a daily basis contract positions over a given threshold that is currently 100 lots for WTI. Where such positions are not held for a member's own account, members are responsible for reporting the name of their customer who holds the position. This information is collected on a daily basis and shared with the FSA, and – for our WTI contract – with the CFTC.

For all contracts ICE Futures Europe has the authority to order a member to reduce the size of a position that it considers to be too large. This is principally of concern in physically-delivered contracts where it appears that a member might have the ability to 'squeeze' the market by controlling a large amount of the contracts to be delivered. In practice it is rare for the exchange to need to mandate the reduction of positions as members wish to avoid disputes with the exchange and will take steps to reduce positions following enquiries from the exchange.

ICE Futures Europe also has the authority to take disciplinary action against its own members. Where necessary it can also notify the Financial Services Authority, the Commodity Futures Trading Commission or other regulators where it would be more appropriate for them to take action.

<u>ICE Futures Europe's Role in the Global Oil Markets</u>

Since its inception, ICE Futures Europe has been a leader in the European crude oil markets. The exchange is the home of the Brent crude oil contract, which has traded in London for twenty-five years. Brent Crude Oil and West Texas Intermediate (WTI) crude oil grades (and to a lesser extent the OPEC Basket and the Dubai Crude Oil) set the global price of oil. The Brent Crude Oil contract is a light, sweet grade of oil and thus is highly correlated with the light, sweet WTI, which is slightly lighter. As one would

expect in a global market, the two contracts usually settle within a few dollars of each other. This has been true since long before ICE purchased the IPE.

ICE Futures Europe introduced its cash settled WTI futures contract in 2006 to compliment its Brent crude oil contract. The ICE Futures Europe WTI contract is cash settled at expiry against the penultimate trading day settlement price established by the NYMEX WTI physically delivered futures contract. Our contract had been launched by ICE several years prior as an OTC swap used primarily by dealers to hedge their customer business. At that time, the NYMEX WTI futures contract was available for trading only on the NYMEX floor. Volume in our OTC WTI swap grew as users found that an electronically traded instrument offered far superior price transparency and execution compared to the NYMEX floor. In response to these growing volumes, we converted our WTI OTC swap to a cash-settled WTI future at ICE Futures Europe to complement our existing Brent crude oil contract. NYMEX subsequently responded to market demands for electronic trading and has recaptured some of the open interest that initially came to ICE Futures Europe. Following NYMEX' introduction of electronic trading, most of the growth in trading of WTI crude oil has been on the NYMEX, as demonstrated by the NYMEX's rising market share and faster growth rate relative to the ICE WTI contract. Nevertheless, the ICE WTI contract is an important contract for ICE Futures Europe, as it is used by commercial market participants to create spread positions with the Brent Crude Oil Contract to hedge exposure to locational differences in the price of global crude oil. Notably, NYMEX offers a cash settled Brent crude oil future for precisely the same reason. Today, ICE has a relatively small 15% share of total WTI futures equivalent open interest, while NYMEX retains the remaining 85%.

Nevertheless, it is clearly important that the CFTC, along with other regulators, have visibility into the entire WTI market given its oversight responsibility with respect to NYMEX. Thus, after introducing the WTI contract in 2006, ICE Futures Europe began sharing information with the CFTC through the CFTC's memorandum of understanding with the FSA. In the original information sharing agreement, ICE Futures Europe provides trader position data for the prompt two months in the WTI contract on a weekly basis. As the contract reaches expiration, this reporting frequency is increased to a daily basis each month. Recently, again working with the CFTC and FSA, ICE Futures Europe agreed to an enhanced information sharing arrangement. This arrangement allows the CFTC to receive daily position data, for all contract months at the client level. In addition, ICE Futures Europe has agreed to notify the CFTC if a trader exceeds position accountability levels similar to those on U.S. DCMs. To our knowledge, the level of information provided through the enhanced information sharing agreement represents a first of its kind in cross-border information sharing between regulators.

CFTC's Mutual Recognition System

ICE Futures Europe operates in the United States as a foreign board of trade. As background, in the Futures Trading Act of 1982, Congress exempted foreign boards of trade from having to register as a DCM. This became the cornerstone of the CFTC's mutual recognition system. In 1996, the Commission issued a no-action letter allowing a German exchange, Eurex, to offer direct electronic access to U.S. customers. The basis of the Commission's ruling was the recognition that Eurex's regulator and regulatory scheme is comparable to that of the CFTC. In 1999, the Commission gave the International Petroleum Exchange no-action relief to enable U.S. based customers to access its electronic market. In 2006, pursuant the no-action letter granted to the IPE, ICE Futures Europe offered the WTI crude oil contract to U.S. based customers.

Through the market evolutions of the past 25 years, including increased globalization, the no-action process has proven highly effective tool for providing information to the U.S. regulator on foreign markets. The CFTC examines several key factors prior to granting relief. These include:

- the automated trading system (including the order-matching system, the audit trail, response time, reliability, security, and, of particular importance, adherence to the International Organization of Securities Commission principles for screen-based trading); the terms and conditions of contracts proposed to be listed;
- settlement and clearing (including financial requirements and default procedures); the regulatory regime governing the foreign board of trade in its home jurisdiction;
- the foreign board of trade's status in its home jurisdiction and its rules and enforcement thereof (including market surveillance and trade practice surveillance); and
- existing information sharing agreements with the foreign board of trade, and the foreign board of trade's regulatory authority.

Since adopting this policy, the CFTC has granted no-action relief to at least twenty foreign boards of trade. In 2006, the CFTC reexamined the no-action process and after a hearing, determined that the no-action policy was an effective tool for both regulatory cooperation and competition.

This mutual recognition system is now a backbone in the global regulatory network. As Benn Steil, Director of International Economics at the Council of Foreign Relations noted, "the U.S. activities of one beneficiary alone [of the no-action process], Eurex have had a tremendous effect in accelerating the move to more efficient electronic trading, in motivating exchanges to demutualize,…in reducing trading fees, and in

stimulating new product development." This is in turn has lead to futures transactions that are faster and less susceptible to manipulation or other bad acts than they were a decade ago, which has greatly reduced the price of risk management and transactional costs to participants in the commodity markets.

It is important to recognize that there is no single agency today that can police all global markets, thus we must rely on foreign regulators if the U.S. is to remain part of the international marketplace. Other countries have similar policies in place, upon which U.S. exchanges rely. The Chicago Mercantile Exchange, NYMEX and ICE Futures U.S. all rely on mutual recognition by foreign regulators to offer global access in those jurisdictions. Failure of the mutual recognition system would greatly impair the competitiveness of U.S. exchanges abroad and represent a major step back for U.S. markets. It is also important to note that the CFTC only can get information on foreign traders trading foreign contracts through information sharing agreements with foreign regulators.

The Price of Oil

ICE recognizes that the rising price of oil has many adverse effects on the U.S. economy and is painful for U.S. citizens. It is tempting to place blame for higher prices on the futures markets, but futures markets serve as the messenger not the fundamental driver of prices. The prices for almost all commodities, including wheat, corn, soybeans, precious and base metals have surged at the rates similar to crude oil and in some cases even more sharply and with greater volatility. It should be noted that in virtually all of these other commodity products, there are no foreign boards of trade offering a contract settling on a U.S. exchange contract to blame. It is also important to note that the price of many non-exchange traded commodities have increased, in some cases even more dramatically, than those traded on an exchange indicating that properly regulated markets, whether domestic or foreign, should not be the scapegoat for rising prices.

The crude oil market, more than most other commodity markets, is global. The United States imports approximately 58 percent of its crude oil from outside the United States. Because crude oil is a global market, regulating the trading of crude oil futures requires international regulatory cooperation, and it is misguided to assume that any one regulator can obtain the entire market picture without the cooperation of regulators in other countries trading other grades of crude oil.

In addition, attempts to artificially influence market prices through government action have historically failed, often with unintended consequences that have been damaging and difficult to repair. One such attempt suggests altering the margining requirements for futures contracts to approximate margining in the securities markets. This concept is misguided due to the economic and contractual differences between the

purchase of a security and of a futures contract. When a stock is purchased, margin signifies a partial payment on an ownership stake in a company with the balance loaned by the customer's broker. It represents a financing arrangement between the broker and the customer. The stock is immediately delivered to the buyer and the transaction is complete from an exchange and clearinghouse perspective. In contrast, margining in futures markets, far from representing a financing arrangement, is the means by which the clearinghouse ensures that there are no losses suffered if and when a member defaults. As a result, futures margin rates are set based on complex mathematical models of contract price history and represent the largest 1 or 2 day price move at an extremely high confidence level. When a futures contract is traded, the buyer and seller take on obligations to take and make, respectively, delivery of the commodity at some later date. Margin represents a performance bond to ensure ultimate delivery or payment. Margins on futures contracts are central to the counterparty risk management systems for clearinghouses. Legislative interference with a basic market mechanism such as margin levels could lead to a number of unintended consequences. Dramatically higher margin rates for futures trading in the U.S. could shift significant exchange- traded volume back into the OTC market where firms would be exposed to the same counterparty risks roiling credit default swap and other markets today. Significantly higher margin rates would likely damage liquidity which would widen the bid-offer spread and increase execution costs for all. Furthermore, failure to adjust margins on a global basis could simply drive trading to overseas markets. Finally, and most tellingly, margin rates for ICE Futures Europe's crude oil contracts have already been raised 300% in the last year due to increased volatility, with no real effect on either the composition of the market or the price of oil.

Attempts to drive "speculation" from the market should also be avoided. It is important to note that speculation does not equal manipulation. Exchanges around the world are required to prevent, detect, and punish manipulation or attempts to manipulate markets. Speculation has always been an essential component of all markets whether prices are falling or rising. There is a common misconception that speculators only bet on prices rising -- this assumption has no basis in fact, and often speculators have a net short bias. Ultimately, futures markets involve contracts in which one side of the market is attempting to predict where the price of a commodity will go in the future, and the other side of the market is attempting to sell or hedge its price risk with respect what the price of a commodity will be in the future. Importantly, neither of these market participants knows what the future will bring. Speculators are simply participants with a view about the future price of a commodity who are willing to put capital to work in assuming the price risk transferred from commercial participants. Speculators are a necessary component of the futures markets, providing liquidity and important pricing information to markets. Without speculators, futures markets would be established solely by commercial participants, in essence, pricing by cartel.

Solutions

Again, the utility function of futures markets is to send important price signals about the future price of commodities as determined by market forces. That said, Congress must insure that markets remain open, transparent and competitive. Global market participants must have regulatory certainty in order to transact confidently in the U.S. markets or they will seek other solutions. We agree with many of you here that the CFTC is under-funded and that Congress should increase the CFTC's budget. ICE strongly supports the budget increase as outlined in Chairman Durbin's bill. Second, the crude oil market is a global market, with many grades of crude substitutable for one another under traded contracts. Regulation of such a market requires global regulatory cooperation, and ICE strongly supports a study of the international regulation of energy markets. Finally, ICE supports the cooperative efforts that presently exist between the CFTC, the UK Financial Services Authority, and other regulators around the world, and urges Congress not to disturb these relationships through over-reaching legislation. It is impossible to regulate a global market from a single jurisdiction, and no country can legitimately contend that it has the sole right to be the jurisdiction in which vibrant commodity markets exist to serve the needs of both domestic and foreign market participants. Over-reaching legislation could also trigger regulatory retaliation from other jurisdictions, impacting the ability of domestic exchanges to operate in other jurisdictions.

Conclusion

ICE has always been and continues to be a strong proponent of open and competitive markets in energy commodities and derivatives, and of appropriate regulatory oversight of those markets. As an operator of regulated futures exchanges in the U.S., the U.K, and Canada, and as a publicly-held company, ICE recognizes the importance of upholding the utmost confidence in its markets. However, with a mere 15% market share of global WTI, on a futures equivalent basis, we feel it is highly unlikely that the ICE Futures Europe's WTI market is the primary driver of WTI prices. Therefore, any expectation that WTI crude oil prices will fall as a result of increased restrictions on this relatively small portion of that market are likely to go unmet. Nonetheless, we recognize the severe impact of high crude oil prices on the U.S. economy and understand the Congressional desire to "leave no stone unturned." As a result, we look forward to working with Congress and the CFTC to ensure that their concerns with regard to the ICE Futures Europe WTI contract are fully addressed while remaining fully compliant with obligations to the primary regulator, the FSA, and U.K. law.

Mr. Chairman, thank you for the opportunity to share our views and facts about our market operation with you. I would be happy to answer any questions you may have.