WRITTEN TESTIMONY OF CHARLES A. VICE
PRESIDENT AND CHIEF OPERATING OFFICER
INTERCONTINENTALEXCHANGE, INC.
BEFORE THE HOUSE
COMMITTEE ON AGRICULTURE
UNITED STATES HOUSE OF REPRESENTATIVES

Chairman Peterson, Ranking Member Goodlatte, 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 the over-the-counter (OTC) energy markets.

Background

ICE is a leading operator of global marketplaces with three regulated futures exchanges and an OTC marketplace offering a wide variety of contracts. As background, ICE was established in 2000 as an electronic OTC platform to serve the energy markets. ICE was established to bring transparency to OTC markets that were traded at that time through opaque OTC voice brokers or through the flawed "one-to-many" Enron Online trading model. In the Enron model, Enron served as both the marketplace for trading and the counterparty to every trade occurring in the market. In stark contrast, ICE sought to develop a neutral "many to many" marketplace, in which we, the operator, take no position in the market while enforcing strict best bid/best offer trading protocols. Trading volume on ICE's OTC markets is almost solely related to contracts for natural gas and power. Our electronic OTC platform has a 0% share of trading in U.S. crude oil, heating oil, jet fuel, and gasoline. ICE's electronic OTC markets have provided cost savings and efficiencies to participants while delivering an unprecedented level of OTC market transparency to both the Commodity Futures Trading Commission (CFTC) and the Federal Energy Regulatory Commission (FERC).

Since the launch of its electronic OTC energy marketplace in 2000, ICE has acquired and now operates three regulated futures exchanges through three separate subsidiaries, each with a separate governance and regulatory infrastructure. The International Petroleum Exchange (renamed ICE Futures Europe), was a 20-year old exchange specializing in energy futures when acquired by ICE in 2001. Located in London, it is a Recognized Investment Exchange, or RIE, operating under the supervision of the UK Financial Services Authority (FSA). In early 2007, ICE acquired the 137-year

IntercontinentalExchange
2100 RiverEdge Parkway
Suite 500
Atlanta, GA 30328
phone 770 857 4700
fax 770 951 1307
online www.theice.com

old "The Board of Trade of the City of New York" (renamed ICE Futures US), a CFTC-regulated Designated Contract Market (DCM) headquartered in New York specializing in agricultural, foreign exchange, and equity index futures. In late 2007, ICE acquired the Winnipeg Commodity Exchange (renamed ICE Futures Canada), a 120-year old exchange specializing in agricultural futures, regulated by the Manitoba Securities Commission, and headquartered in Winnipeg, Manitoba.

ICE Operates a Transparent OTC Marketplace

Over-the-counter markets ranging from U.S. interest rate instruments to foreign exchange and debt securities are increasingly global and have migrated to electronic platforms due to their vast size and global nature As I mentioned, in 2000 ICE developed an electronic, many-to-many electronic marketplace for trading both physical energy commodities and financially-settled over-the-counter derivatives based on energy commodities. ICE in effect performs the same functions as "voice brokers" in the OTC market, but does so through a transparent electronic trading platform with strict trading protocols. Voice brokers offer limited transparency and tend to transact with only the largest trading firms, and continue to serve as the primary venue for OTC oil trading today. ICE's OTC model, though not active in US crude oil, provides equal access to high quality information to all market participants, whether the smallest utility or the largest investment bank, primarily for natural gas and power. ICE's marketplace offers faster and more efficient trade execution while providing regulators with a comprehensive audit trail with respect to orders entered and transactions executed in the markets, none of which is available from voice brokers.

The development of ICE's OTC marketplace has also promoted competition and innovation in the energy derivatives market, to the benefit of both market participants and consumers. The increased liquidity offered by electronic trading has resulted in lower transaction costs and tighter bid/ask spreads, reducing the cost of hedging energy price risk and lowering operating costs for businesses. The reliability of ICE's markets has also resulted in an increasing preference for electronic trading in these markets. NYMEX, in its recent testimony before the Senate Permanent Subcommittee on Investigations (the "Senate PSI"), noted that 80-85% of its futures volume is now traded electronically, a development driven largely by competition from ICE. The CFTC also pointed out, in its Senate PSI testimony, that "the ability to manipulate prices on either [NYMEX or ICE] has likely been reduced, given that ICE has broadened participation in contracts for natural gas."

Like other electronic marketplaces, participants on ICE enter bids and offers electronically. Transactions are matched in accordance with an algorithm that executes transactions on the basis of time and price priority. Participants executing a transaction on our platform may settle the transaction in one of two ways – on a bilateral basis,

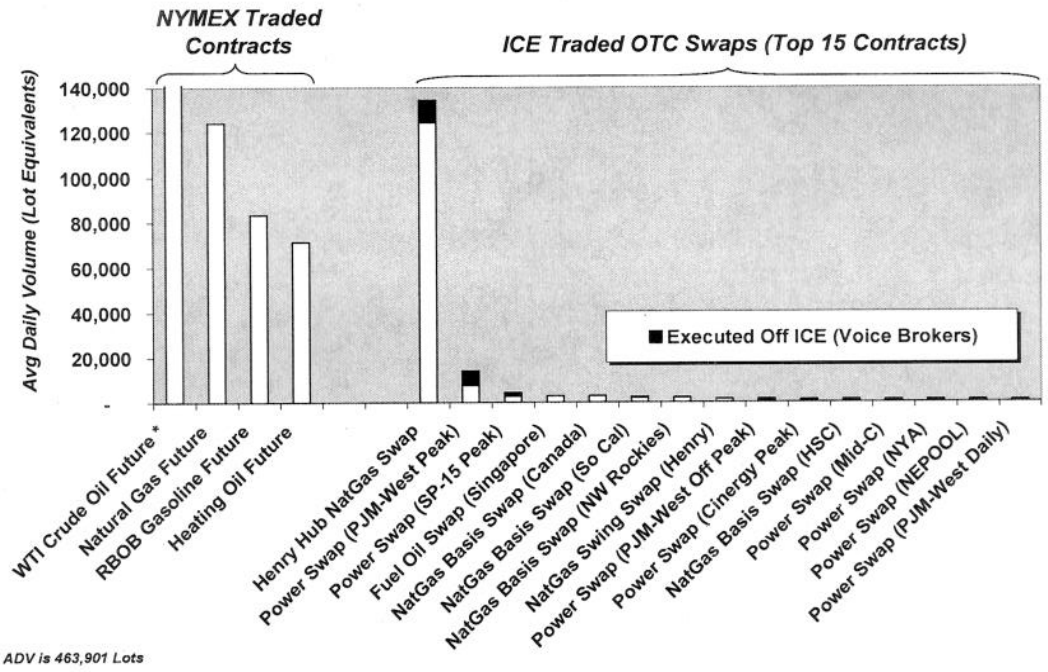
settling the transaction directly between the two counterparties to the trade, or on a cleared basis through a clearinghouse using the services of a futures commission merchant that is a member of the clearinghouse.

It is important to note that there are substantial differences between ICE's OTC market, other portions of the OTC market, and the NYMEX futures market. These differences necessarily inform and guide the appropriate level of oversight and regulation of our markets. First, ICE is only one of many global venues on which market participants can execute OTC trades. A significant portion of OTC trading in natural gas continues to be executed through voice brokers or through direct bilateral negotiation between market counterparties. Of the available forums, only ICE (and any other similarly-situated ECM) is subject to CFTC jurisdiction and the CFTC's regulations, and to limitations on the nature of its participants.

Second, participants in a given futures market must become members of the relevant exchange or trade through a futures commission merchant that is a member. In contrast, ICE's OTC market, by law, is a "principals only" market in which participants must execute trades in their own names on the system. This market is designed solely for sophisticated participants, and participation in ICE OTC markets, unlike most other OTC venues is fully documented.

Third, the OTC market offers a substantially wider range of products than the futures markets, including, for example, hundreds of niche derivative contracts on natural gas and power at over 100 different delivery points in North America. The availability of these niche markets on ICE has improved transparency and lowered transaction costs via tighter bid-ask spreads, but volume nonetheless remains very low at most points. The market reality, for most of these illiquid points, is that participation is limited to the very small number of marketers, utilities, and others that have some intrinsic supply or demand interest in specific delivery points. Below is a chart[1] that compares the relative size of NYMEX traded futures contracts and ICE's largest electronic OTC energy markets.

[1] From the testimony of Jeffrey Sprecher, IntercontinentalExchange, Inc. CEO before the U.S. Senate Permanent Subcommittee on Investigations, June 25, 2007.



Fourth, the most liquid products traded in OTC markets broadly, and in the ICE OTC market specifically, are cash-settled derivatives contracts that require one party to pay to the other an amount determined by the final settlement price in the corresponding futures contracts. Such cash-settled swaps do not, and cannot, result in the physical delivery or transfer of energy commodities. These derivative contracts have been widely used by OTC energy market participants long before the creation of ICE. In fact, these contracts are useful and common in any market for which there are benchmark futures prices. Our Henry Hub natural gas swap, for example, constitutes an important commercial hedging vehicle and has served as an important complement to and as a hedge for the NYMEX Henry Hub natural gas futures contract. This same contract is now subject to the same futures-style regulation that applies to a DCM contract.

Greater Oversight over Exempt Commercial Markets (ECMs)

As the OTC markets have grown and developed since passage of the Commodity Futures Modernization Act, new regulatory challenges have emerged. In May, as part of the farm bill, Congress, with strong bipartisan support, passed legislation providing the CFTC with greater oversight of electronic OTC markets, or ECMs. As a result of that new law, ECMs are now obligated to apply market oversight principles equivalent to

those employed by fully regulated futures exchanges for larger OTC contracts that, like futures contracts, serve a significant price discovery function.[2]

As part of its new authority, the CFTC will determine whether contracts traded on ECMs serve a significant price discovery function, which broadly includes contracts that are linked to a futures exchange's contracts or which have independently been adopted by the marketplace as a price reference for the underlying energy commodity.

If the CFTC determines that an ICE contract serves a significant price discovery function, ICE will thereafter have self-regulatory responsibilities with respect to such contract similar to those of a DCM, or futures exchange. As a self regulatory organization, ICE will be required to discharge seven core principles, which cover all of the core principles discharged by futures markets other than those applicable to brokers and intermediated trades, which by law cannot occur in an ECM's markets. Specifically, the core principles state that the ECM shall:

- List only significant price discovery contracts that are not readily susceptible to market manipulation
- Monitor trading in its significant price discovery contracts to prevent market manipulation
- Establish and enforce rules have the ability to obtain information to comply with the core principles
- Adopt position limits or accountability limits
- Adopt rules to give it the authority to liquidate open positions and suspend trading in significant price discovery contracts
- Monitor and enforce compliance with its rules
- Establish and enforce rules to minimize conflicts of interest

Importantly, as I will explain further, the legislation provides equivalent regulation for "futures like" OTC contracts, while avoiding unintended the consequence of driving trading in illiquid OTC contracts to the opaque, voice brokered parts of the OTC market. The CFTC has virtually no visibility into these OTC markets because they are not traded on an electronic platform like ICE.

One Size of Regulation Does Not Fit All Markets or Contracts

Even though Congress has increased the oversight and regulation of ECMs, some have argued that all contracts should be traded on a designated contract market. The problem with "one size fits all" regulation can best be illustrated by contrasting the historic nature of futures markets (limited number of actively traded benchmark

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

contracts, all transactions executed through a broker who can trade for its own account or that of a retail customer) with the ECM OTC swaps markets (large number of niche products, many illiquid and thinly traded, principals only trading). Recognizing the importance of futures pricing benchmarks to the general public (a DCM is obligated to publish its prices to be used by the broader market), and in recognition of the potential for conflicts of interest due to members trading for their own accounts alongside business transacted on behalf of customers, some of whom were retail customers, DCM core principles were developed to facilitate regulation of the markets by the DCM, which acted as a self regulatory organization. The typical high level of liquidity in benchmark contracts make application of core principles such as market monitoring and position accountability and limits feasible and appropriate.

Suggesting that these same DCM core principles, which were developed with the futures exchange model in mind, should apply to all OTC swap contracts traded on an ECM market is attempting to fit the proverbial square peg in a round hole. Most of the energy swaps available on ICE are niche OTC products that trade in illiquid markets that are simply not amenable to the application of DCM core principles. For example, does it make sense to publish a real-time price feed for a market in which real-time bids and offers are rare and days pass between trades? Also, how would an ECM actively monitor an illiquid swaps market in an attempt to "prevent manipulation" where there may be few or no trades due to the limited liquidity in the market? How would an ECM swaps market administer accountability limits in a market that has only a handful of market participants? Should the ECM question when a single market participant holds 50% of the liquidity in an illiquid market when the market participant is one of the only providers of liquidity in the market?

It is important to analyze these questions not in isolation, but in the context of market participants having alternatives such as OTC voice brokers or overseas markets through which they can conduct their business. Importantly, such OTC voice brokers can even offer their customers the benefits of clearing through use of block clearing facilities offered by NYMEX and by ICE. Faced with constant inquiries or regular reporting by the ECM related to legitimate market activity, and facing no such monitoring when it transacts through a voice broker, market participants might choose to conduct their business where transparency and reporting requirements are non-existent. It is for these and other reasons that Congress and the Commission have developed the carefully calibrated three-tiered regulatory structure applicable to DCMs and ECMs. We believe that the judgments made by Congress and the CFTC thus far have been prudent and should be maintained.

ICE

Conclusion

In conclusion, ICE remains a strong proponent of open and competitive OTC markets and of appropriate regulatory oversight of those markets. The recently passed farm bill places a significantly higher level of regulation on electronic OTC energy platforms. In doing so, Congress appropriately recognized the importance of focusing on the relatively small number of larger OTC contracts that perform a significant price discovery function, rather than the hundreds or even thousands of OTC contracts that are rarely traded.

ICE recognizes the severe impact of high crude oil prices on the U.S. economy and understands the Congressional desire to "leave no stone unturned." However, since our electronic OTC platform has a 0% share of trading in U.S. crude oil, heating oil, jet fuel, and gasoline, further regulation or even elimination of electronic OTC markets by Congress is certain to have no effect on oil prices. Such moves would, unfortunately, though, ensure that OTC oil trading continues to be executed by brokers over the telephone in a manner completely opaque to the marketplace and regulators.

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