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TESTIMONY OF JOHNATHAN SHORT
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BEFORE THE COMMODITY FUTURES TRADING COMMISSION AND
THE SECURITIES AND EXCHANGE COMMISSION

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Chairman Gensler, Chairman Schapiro, CFTC and SEC Commissioners, I am Johnathan Short, Senior Vice President and General Counsel of the IntercontinentalExchange, Inc., or "ICE." I appreciate the opportunity to appear before you today to discuss rule harmonization between the two agencies. As a global operator of both regulated energy futures exchanges, electronic over-the-counter energy markets, and credit default swaps clearinghouses, ICE firmly believes in the proper regulation of markets to ensure that market users, as well as the broader public, have confidence in our markets.

Background

ICE was established in 2000 as an electronic over-the-counter (OTC) market. Since that time, ICE's markets have grown significantly fostered by our product, technology and trading innovations, as well as by acquisition of other businesses to broaden our product offerings.

Since the launch of our electronic OTC energy marketplace in 2000, ICE has acquired and now operates three regulated futures exchanges through three separate subsidiaries, each with its own 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 U.K. Financial Services Authority (FSA). In early 2007, ICE acquired the 137-year old "The Board of Trade of the City of New York" (renamed ICE Futures U.S.), 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.

In addition to its execution venues, ICE also owns and operates five derivatives clearing houses across the U.S., Canada and Europe, serving both regulated futures exchanges and over-the-counter clearing businesses globally. These clearing houses include:



- ICE Clear U.S., a Derivatives Clearing Organization under the Commodity Exchange Act, located in New York and serving the markets of ICE Futures U.S.;
- ICE Clear Europe, a Recognized Clearing House located in London that serves ICE Futures Europe, ICE's OTC energy markets and also operates as ICE's European CDS clearing house through a separate risk management framework;
- ICE Clear Canada, a recognized clearing house located in Winnipeg, Manitoba that serves the markets of ICE Futures Canada;
- ICE Trust, a special purpose U.S.-based clearing house serving the CDS sector which has cleared CDS transactions with notional value in excess of two trillion dollars since its launch in March 2009; and
- The Clearing Corporation (TCC), established in 1925 as the nation's first independent futures clearing house. TCC provides the risk management framework, operational processes and clearing infrastructure for ICE Trust. The Clearing Corporation also provides clearing services to the Chicago Climate Futures Exchange.

Throughout the financial downturn, each of our execution and clearing venues has operated efficiently and effectively to serve the risk management needs of the broader marketplace. ICE has established a track record of working with market participants to introduce transparency and risk intermediation into formerly opaque markets, and has worked closely with regulators to improve supervision and access to market information. Along with the introduction of electronic trading to energy derivatives markets, ICE pioneered the concept of cleared OTC energy swap contracts. ICE's development of OTC clearing has supported healthy market reform, and clearing of OTC derivatives has been replicated by other major exchanges and clearing houses across many segments of the OTC marketplace.

With this background, ICE comes before you today to testify on exchange regulation and harmonization of the SEC and CFTC's regulatory structure.

The SEC and CFTC Should Adopt Common Core Principles

Currently, the SEC and CFTC have different approaches to market regulation. The CFTC uses core principles to prescribe conduct for exchanges and clearing houses. These core principles are tailored using acceptable practices that have evolved with changes in the global marketplace, and which give CFTC registrants a legal safe harbor to comply with the core principles. On the other hand, the SEC uses prescriptive based



rules to regulate markets. Given the complexity and continuing evolution of global financial markets, ICE believes that a broad set of core principles governing markets would allow the SEC and the CFTC to work towards the common goal of protecting market integrity and reducing systemic risk.

Core principals allow financial regulation to be flexible and prudential. Flexibility is important, as it allows regulators to respond to changing market dynamics and anticipate future problems rather than living by prescriptive regulations that were designed to address yesterday's markets and yesterday's problems. To be flexible, regulators must also be prudential, with an intimate understanding of their markets and market participants. This depth of knowledge is required to tailor effective regulation to ensure market integrity and consumer protection. Core principles guiding the SEC, the CFTC and market participants will help achieve this goal. Furthermore, there should be an active and ongoing dialog between the SEC and the CFTC about acceptable practices for implementation of core principals so that opportunities for "regulatory arbitrage" are minimized.

While harmonization of the two regulatory systems and prevention of regulatory arbitrage should be an objective, core principles should be flexible enough to permit differences in regulation where the primary purposes of markets warrant such differences. For example, the standard of proof for manipulation in securities markets as defined by certain circuits is "extreme recklessness" pursuant to SEC Rule 10b-5¹. This standard works well for the securities markets, where the primary goal is to protect retail investors from fraud and deception. Commodities markets, on the other hand, are price discovery venues where it is important to encourage all expressions of price in order for effective price discovery to occur. Implementation of a "recklessness" standard might inhibit market participants from expressing divergent views of price out of fear that they would be subjected to liability, thus inhibiting the price discovery process. Therefore, it would be appropriate to maintain the current standard of proving a specific intent to create an artificial price for proving manipulation in futures markets.

Similarly, adopting the SEC's insider trading prohibitions in the commodities markets could impair price discovery and efficient markets. Insider trading prohibitions in the securities markets are based upon the premise that corporate executives and other fiduciaries should not use their privileged access to information to trade when such material information is not available to the broader marketplace. In the commodities derivatives markets, however, market participants typically trade based upon their own informed self-interest, often hedging price risks that are, by definition, based upon information that is not available to the broader marketplace and which contributes to the futures price formation process.

¹ Securities and Exchange Act of 1934, Section 10(b); Rule 10b-5, 17 C.F.R. 240.10b-5



The SEC and the CFTC Should Take a Unified Approach to Global Regulation

It is also important for the SEC and CFTC to recognize that the financial markets are global in nature. ICE operates markets in the United States, Canada and Europe, with screen-based access to our exchanges available in over fifty jurisdictions. U.S. regulators must be cognizant that burdensome, duplicative or conflicting regulation can increase transaction costs that will ultimately be born by end users of the marketplace, and which may inadvertently drive liquidity to other markets.

Like the CFTC and the SEC's divergent regulatory models, foreign regulators may approach regulation in a different manner than the U.S. When examining these different regimes for the purposes of recognition, U.S. financial regulators should focus on whether the regulatory system is *comparable*, but should not mandate *identical regulation*. This is important because attempting to impose identical regulation on other countries will only lead to less regulatory cooperation and the potential for retaliation by foreign regulators.

Again, a common set of core principles offers the best structure for a unified approach to global regulation. These core principles should be consistent with the International Organization for Securities Commission's (IOSCO) principles for securities regulation and comply with the core principles' main objectives to protect investors, to ensure fair, efficient and transparent securities markets and to reduce systemic risk. A common global regulatory approach will provide U.S. financial market participants with greater access to global markets while ensuring that regulatory gaps do not set conditions precedent for another financial crisis.

The CFTC and SEC Should Ensure that New Regulations do not Impose Duplicative or Conflicting Requirements

The United States financial regulatory system is unique in that it has various regulators for different types of financial transactions. As stated previously, different approaches to financial regulation can have positive benefits by giving regulators the ability to focus on the key issues in their respective markets. However, a fractured financial regulatory system can also have negative consequences if significant regulatory overlap exists. Market participants may be exposed to varying and conflicting standards of conduct, resulting in increased compliance costs which, in most cases, are passed on to end users.

Thus, in the upcoming rule harmonization efforts between the SEC and the CFTC, the Commissions should attempt to avoid duplicative and overlapping regulation where



possible. Clear regulatory lines should be drawn that give market participants certainty that their transactions are overseen by the appropriate regulator.

Conclusion

ICE has always been and continues to be a strong proponent of open and competitive markets, and of appropriate regulatory oversight of those markets. As an operator of global derivatives markets, and as a publicly-held company, ICE advocates a regulatory framework that ensures the utmost confidence in its markets. To that end, we have continuously invested in and expanded our own regulatory infrastructure, while working closely with regulatory bodies in the U.S. and abroad to achieve the aims of broad market security, transparency and regulatory certainty.

Thank you for the opportunity to share our views with you. I would be happy to answer any questions you may have.