WRITTEN TESTIMONY OF CHRIS EDMONDS,
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ON BEHALF OF INTERCONTINENTAL EXCHANGE, INC.
BEFORE THE HOUSE AGRICULTURE COMMITTEE

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Introduction

Chairman Thompson, Ranking Member Scott, I am Chris Edmonds, Chief Development Officer for Intercontinental Exchange, or ICE. I appreciate the opportunity to appear before you today, as this Committee looks at the global commodity market volatility and the impacts on central clearing and margin.

Clearing houses play a critical role in the financial markets that serve the needs of participants around the globe. Policy makers across the world, including this Committee, have an interest in safe and efficient markets. To further the common interest of well-functioning markets and well-regulated clearing houses, we appreciate the opportunity to participate in this hearing.

Background

Since launching an electronic over-the-counter (OTC) energy marketplace in 2000 in Atlanta, Georgia, ICE has expanded both in the U.S. and internationally. Over the past seventeen years, we have acquired or founded derivatives exchanges and clearing houses in the U.S., Europe, Singapore and Canada. In 2013, ICE acquired the New York Stock Exchange, which added equity and equity options exchanges to our business.

ICE has a successful and innovative history of clearing exchange-traded and OTC derivatives across a spectrum of asset classes, including energy, agriculture and financial products. Today, ICE owns and operates six geographically diverse clearing houses that serve markets and customers across North America, Europe and Asia. Each of these clearing houses is subject to direct oversight by local national regulators, often in close coordination and communication with other regulatory authorities with important interests, and subject to regulations reflective of the G-20 reforms and IOSCO principles.

- ICE acquired its first clearing house, ICE Clear U.S., as a part of the 2007 purchase of the New York Board of Trade. ICE Clear U.S. clears a variety of agricultural and financial derivatives and is primarily regulated by the Commodity Futures Trading Commission (CFTC) and is recognized by the European Securities and Markets Authority (ESMA).
- In 2008, ICE launched ICE Clear Europe, the first new clearing house in the UK in over a century. ICE Clear Europe clears derivatives in several asset classes, including energy, interest rates, equity and credit derivatives, and is primarily supervised by the Bank of England, in close cooperation with the CFTC, the Securities and Exchange Commission (SEC) and ESMA.
- ICE Clear Credit was established as a trust company in 2009 under the supervision of the Federal Reserve Board and the New York State Banking Department and converted to a derivatives clearing organization (DCO) following implementation of the Dodd-Frank Wall

Street Reform and Consumer Protection Act (Dodd-Frank Act). ICE Clear Credit clears a global set of credit default swaps on indices, single names and sovereigns, and is primarily regulated by the CFTC and SEC and is also recognized by ESMA. ICE Clear Credit has been designated as "systemically important" by the Financial Stability Oversight Council (FSOC).

- In 2017, ICE acquired ICE NGX. ICE NGX operates a non-intermediated model for clearing of North American energy products and is regulated by the Alberta Securities Commission and the CFTC.
- ICE also operates ICE Clear Netherlands under the regulatory supervision of De Nederlandsche Bank, Autoriteit Financiële Markten and ESMA, and ICE Clear Singapore which is overseen by the Monetary Authority of Singapore.

Clearing Houses Vital Role in the Derivatives Market

Clearing has consistently proven to be a fundamentally safe and sound process for managing systemic risk. The risk-reducing benefits of central clearing have long been recognized by users of exchange-traded derivatives (futures), and the performance of the clearing model throughout even the most challenging financial situations made it the foundation of financial reforms. Observers frequently point to non-cleared derivative contracts as a significant factor in the broad reach and complexity of the 2008 financial crisis, while noting the relative stability of cleared markets.

The disciplined and transparent risk management practices of regulated clearing houses serve to reduce systemic risk. A clearing house, by acting as a central counterparty, to clearing members' transactions, eliminates the bilateral counterparty credit risk and imposes on clearing members a transparent set of rules and prudent risk management practices, such as margin requirements, to minimize risks managed by the clearing house. Clearing house risk management practices have been repeatedly tested and proven in resolving defaults including large bankruptcy proceedings, such as Lehman Brothers and MF Global, and during extreme market events such as the COVID-19 pandemic and the Russian invasion of Ukraine.

As part of the increased use of clearing, clearing houses and market participants have worked to make the clearing process robust and resilient, supported by suitable financial, risk management, and operational resources. The Principles for Market Infrastructure (PFMI) represent the internationally agreed-to framework for achieving these goals and are designed to ensure that fundamental protections apply internationally. National regulators in G-20 jurisdictions have reduced the risk of regulatory arbitrage by implementing the key aspects of the PFMIs into their regulatory frameworks. This process has set an appropriate standard across numerous jurisdictions for the regulation of a clearing house.

The Purpose of Liquid Markets

This past year is a reminder that well-hedged utility and energy firms serve a wider public good by increasing resilience of the energy supply chain and serving the interests of many stakeholders. In periods of heightened uncertainty and volatility, risk transfer mechanisms are most needed as the risks in the underlying commodity markets are most acute. The primary objective of market operators and policymakers should be to keep markets open and available to all market participants, especially during times of increased stress.

Commercial market participants rely on ICE's exchanges and clearing services to assess price risks, find market opportunities and transact with confidence. Futures markets allow market participants to manage their risk of adverse price moves by securing the price for future consumption or delivery of a commodity. By managing price risk, market participants can make business decisions with more confidence, creating an environment that is conducive to infrastructure investments that reinforce the security of supply or that facilitate the energy transition. ICE is proud to operate the liquid markets that contribute to energy security, which in turn promotes national security and allows policy makers to make informed decisions.

In addition, futures markets provide commercial market participants with tools for effective hedging and price certainty, which reduces the cost of capital and, in turn, reduces costs to consumers. ICE's global exchanges offer commodity derivative contracts such as power, gas and oil which enable commercial market participants including utility and energy firms to optimize cash flows associated with underlying physical deals through buying and selling futures and options.

Market Performance and Central Clearing

The combination of market events in 2022 has been unique -- the uneven and unpredictable reopening of global economies following the COVID-19 pandemic, the Russian invasion of Ukraine significantly reconfiguring global energy supply, rising inflation and subsequent central banks tightening of monetary policy and increasing political and investor pressure around energy markets and energy security, affordability and sustainability. These events have impacted the financial and commodity markets and have combined to create significant uncertainty, high levels of volatility and high energy prices at a time where the cost of capital has also increased.

Despite the challenges related to these events, derivative markets have again proven to be resilient, liquid and well-functioning and continue to facilitate price discovery through liquid and fair markets. As a result of market events, volatility increased and market participants faced liquidity demand increases including initial and variation margin calls. Margin levels were near record highs, as clearing houses' margin requirements responded as designed to protect against rapidly shifting prices. Clearing house margin requirements are risk-based and respond on a dynamic basis to changing market conditions. These margin models are designed by risk experts, vetted with clearing members, approved by regulators, and regularly back-tested in compliance with international standards and regulatory requirements.

Market participants made variation margin calls (paid their bill) or received variation margin payments (were paid what they were owed). The fact that these parties paid their margin calls is further evidence that the markets operated as expected and that market participants confidently relied on ICE's markets to manage their risks. Global regulators and market operators have also

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observed and acknowledged that the derivative markets operated efficiently and effectively as intended.[1]

European Price Caps

ICE recognizes the volatile situation occurring in energy markets and its subsequent impact on consumers. We also acknowledge the merits of governments exploring solutions to address high natural gas prices and supply concerns. ICE however does not support the recent imposition of a market correction mechanism in the European Union ("EU") and believes it will not achieve its primary objective of lowering energy prices and could distort the trading of EU natural gas derivatives.

The implementation of the market correction mechanism undermines the ability of the market to perform vital risk transfer mechanisms resulting in commercial market participants being unable to manage their risk. Gas derivatives, such as the ICE TTF futures contract, are a crucial tool for producers and consumers to hedge against the risk of changes in future gas spot prices. If a change to future supply or demand occurs, market participants need the ability to react to these changes in order to remain properly hedged. Imposing a price limit on exchange-traded products subjects market participants to greater risk exposure and uncertainty. The market correction mechanism incentivizes market participants to use less transparent over-the-counter hedging tools or refrain from hedging, which could have a detrimental impact on liquidity and market confidence and result in long-term damage to the functioning and competitiveness of the European gas market.

Furthermore, a critical feature of central clearing is the ability to manage the default of market participants and to prevent systemic risk by unwinding the positions of a defaulting clearing member and returning the market to a balanced book. The introduction of a price cap on a contract prevents the clearing house from performing this function, increasing risks to the clearing house and systemic risks to the broader market. A price cap undermines financial stability with no remedy. It is critical that the U.S. not jeopardize robust and well-functioning markets through government intervention.

Central Counterparties Access to Central Bank Accounts

Clearing houses collect and manage billions of dollars in customer funds pledged as collateral against derivatives positions including margin posted by commercial hedgers and farmers. The amount of collateral posted to clearing houses has substantially increased due to recent market volatility. Accordingly, expanding clearing house access to central bank deposit accounts for client margin is an important systemic risk mitigation tool and a means to protect client funds held by clearing houses and ensure liquidity of these funds during stressed market conditions.

Clearing houses without access to central bank deposit accounts rely on alternatives for cash management of client funds, such as money market funds, repurchase agreements, and

[1] Please refer to the testimony of Chairman Benham at the 2022 U.S. Treasury Market Conference where he discussed the resiliency and well-functioning of markets during recent market volatility. https://www.cftc.gov/PressRoom/SpeechesTestimony/opabehnam27

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deposits at commercial banks. Jurisdictions including the United Kingdom and EU allow clearing houses access to central bank deposit accounts under certain circumstances. In the U.S., under Title VIII of the Dodd-Frank Act, the Federal Reserve was authorized to provide deposit account access only to financial market utilities deemed systemically important by the FSOC. During times of stress and increased market volatility, access to a Federal Reserve deposit account for all clearing houses will improve liquidity across the cleared derivatives ecosystem and reduce the systemic risk created by the interconnectedness of clearing houses and banks. It will also protect customers and end-users using the derivatives markets to hedge risk.

ICE supports legislation providing all central counterparties registered with the CFTC and SEC access to deposit accounts offered by the Federal Reserve as it is the safest and most liquid place to hold U.S. dollar client funds and asks the committee to assist in advancing such legislation.

Conclusion

ICE has always been, and remains, a strong proponent of open and competitive markets with appropriate regulatory oversight. As an operator of global futures and derivatives markets, ICE understands the importance of confidence in its markets, and we take seriously our obligations to mitigate systemic risk. ICE has observed its markets operating efficiently and effectively especially in times of market stress. To that end, we have worked closely with regulatory authorities in the U.S. and abroad to ensure they have access to all relevant information available to ICE regarding trade execution and clearing activity on our markets. We look forward to continuing to work closely with governments and regulators at home and abroad to address evolving challenges and to expand the use of demonstrably beneficial clearing services that underpin the best and safest marketplaces possible.

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

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